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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

PEOPLE OF THE STATE OF CALIFORNIA, Plaintiff, **v.** **THE MCGRAW-HILL COMPANIES, INC., STANDARD & POOR'S FINANCIAL SERVICES LLC, AND DOES 1-100,** Defendants.	Case No. **COMPLAINT FOR TREBLE DAMAGES, CIVIL PENALTIES AND PERMANENT INJUNCTION FOR VIOLATION OF THE CALIFORNIA FALSE CLAIMS ACT, UNFAIR COMPETITION LAW, AND FALSE ADVERTISING LAW**

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The People of the State of California, by and through Kamala D. Harris, Attorney General of the State of California, based on information and belief, bring this action against The McGraw-Hill Companies, Inc. and Standard & Poor's Financial Services LLC (collectively "S&P").

INTRODUCTION

1. In the years leading up to the 2007-08 financial crisis, S&P intentionally inflated its ratings of structured finance securities, costing California's public pension funds and other investors hundreds of billions of dollars when those overrated securities later collapsed. S&P purported to be a neutral gatekeeper of the financial markets, dispensing impartial ratings on tens of thousands of complex, opaque securities. Investors, including California's public pension funds, relied on S&P's integrity and its ratings. That reliance turned out to be misplaced. In reality, S&P corrupted its ratings process to curry favor with large banks, which paid S&P billions of dollars in return. In other words, S&P claimed to be a gatekeeper, but it acted like a toll collector.

I. S&P's Claims About Itself and Its Ratings

2. S&P made many specific claims to investors and the general public about how it ran its business. For example, S&P promised that the fees it collected from banks and other security issuers would never affect the ratings it gave those securities. It represented that it had impenetrable ethical walls protecting the S&P analysts who rated structured finance securities from pressure due to "an existing or a potential business relationship between [S&P] . . . and the issuer." Issuer fees, S&P promised, could "not be a factor in the decision to rate an issuer or in the analysis and the rating opinion."

3. S&P also advertised the purported reliability and high quality of its ratings. It claimed, for instance, that an AAA rating meant that a security had an "[e]xtremely strong capacity to meet financial commitments." An AAA-rated security was, according to S&P, safer than all but a small handful of the very highest quality corporate bonds – as secure as U.S. Treasury bonds.

II. Investors, Including California's Public Pension Funds, Relied on S&P's Ratings

4. S&P's ratings played a crucial role in the worldwide market for structured finance securities for a number of reasons. Among the most important, S&P was in a position to know – and did know – far more about these securities than investors, such as California's public pension funds. For example, all of the securities relevant to this case were issued by pass-through vehicles that depended entirely on income from portfolios of assets. Investors did not know what assets were in the portfolios held by those vehicles. That information was considered confidential by the banks that created the vehicles, so investors only received general descriptions of the assets backing their investments. S&P, however, received detailed information about every single asset backing the securities it rated. It claimed to carefully evaluate each asset before rating the securities. Lacking the same level of information, investors had little choice but to rely on ratings from S&P and its competitors.

5. Another reason S&P's ratings played a key role was the fact that most purchasers of structured finance securities had investment rules that sharply limited their ability to buy such securities if they were not rated AAA by at least two of the three leading agencies: S&P, Moody's, and Fitch. For example, the California Public Employees Retirement System ("PERS") and the California State Teachers Retirement System ("STRS") had rules that in many instances required them to buy only AAA-rated structured finance securities. S&P was aware of this and knew investors would rely on its ratings.

6. Relying on S&P's ratings, PERS and STRS collectively purchased billions of dollars worth of structured finance securities, including those listed on Appendix A. As set forth in Appendix A, many of those securities were rated AAA by S&P.

III. The Truth About S&P's Integrity and Ratings

7. In reality, S&P secretly lowered its rating standards in order to gain market share and increase profits in its rating business. S&P executives were keenly aware of actual and potential competition and were determined to defeat it – at any cost. They siphoned resources away from their analysts and intentionally inflated their ratings in order to attract and keep bank

business. They suppressed development of new, more accurate rating models that would have produced fewer AAA ratings – and therefore lower profits and market share. As one senior managing director at S&P later confessed, "I knew it was wrong at the time."

8. Between 2004 and 2007 (the "Relevant Time Period"), S&P knew that its rating process and criteria had become so degraded that many of its ratings were, in the words of one S&P analyst, little better than a "coin toss." During those years, its models were "massaged" using "magic numbers" and "guesses," in the words of other senior S&P executives.

9. By 2004, S&P had compromised its rating process to the point where S&P had no basis to believe that its ratings met its own announced standards. Quite the contrary, S&P had ample reason to believe the opposite. And S&P in fact did not hold the ratings "opinions" it represented to investors such as PERS and STRS.

10. For example, in 2004, S&P knew that changes in the residential mortgage market had rendered obsolete its ratings model for residential mortgage backed securities ("RMBS"), one of the main types of securities at the heart of this case. As a result, S&P's RMBS model rated these securities too highly and understated their risks. S&P analysts developed an updated model that reflected current housing realities. They then tested their new model by running it on a sample of several RMBS that had already been rated by S&P using its old model. The test results showed that all of the sample RMBS had substantial flaws and were significantly riskier than S&P's ratings indicated. This created a business and ethical problem for S&P. If it used the new – and more accurate – model, S&P would lose business to less demanding competitors. So S&P management refused to implement the new, more accurate model. S&P continued to use the obsolete, inaccurate model for three more crucial years, thus providing inflated ratings to thousands of RMBS.

11. It was not until mid-2007, when the housing bubble had already begun to burst, that S&P finally authorized an update to its inaccurate RMBS model. Even then, S&P only used a watered-down version of the proposed 2004 model – which itself had become obsolete over the three intervening years. Thus, S&P continued to issue RMBS ratings that it knew were inaccurate and inflated.

12. S&P similarly corrupted its ratings of other mortgage-related structured finance securities. For instance, it rated notes issued by structured investment vehicles ("SIVs") – another type of security central to this case – without obtaining key data about the assets underlying the SIVs. A reporter later asked the responsible executive about this failing: "If you didn't have the data, and you're a data-based credit rating agency, why not walk away" from rating these deals? His response was remarkably candid: "The revenue potential was too large."

13. S&P employees minced no words when describing S&P's woefully inadequate ratings process in the mid-2000s. One called it a "f**king scam." Another said, "Let's hope we are all wealthy and retired by the time this house of cards falters."

IV. The House of Cards Burns Down

14. By early 2007, the risk disparity between S&P's high ratings on structured finance securities and the low quality of the mortgages backing them had reached the point where it was a source of humor inside S&P. On March 19, 2007, some of the S&P analysts involved in rating these securities recorded a parody of the Talking Heads song "Burning Down the House" with the following lyrics:

> Watch out!
> Housing market went softer
> Cooling down
> Strong market is now much weaker
> Subprime is boi-ling ov-er
> Bringing down the house
> . . .
> Going all the way down, with
> Subprime mortgages.

15. S&P did not share this cautionary ditty with investors. Rather, it continued to issue ratings that it knew did not capture the risks of the "strong market" for housing – despite the fact that its analysts clearly were aware that the housing market was "now much weaker." S&P even continued to grant AAA ratings to numerous securities backed by toxic subprime mortgages. California's pension funds bought such securities in reliance on S&P's ratings. And, as predicted by S&P's lyrical analysts, those securities did indeed "go all the way down," causing massive losses to the pension funds and other investors.

16. By the second half of 2007, the problems with RMBS and related securities had become too public for S&P to ignore. Securities that S&P had claimed were in the least risky possible category, AAA, were defaulting and suffering losses at rates resembling junk bonds.

17. S&P therefore decided to downgrade these securities en masse, beginning with subprime RMBS in July 2007. In the market collapse that occurred after the risky nature of RMBS and related securities became known, PERS and STRS lost hundreds of millions of dollars on RMBS and SIVs that had been rated AAA by S&P.

18. PERS's and STRS's losses were not a statistical anomaly; they do not represent a cluster of investments that all happened to fall within the .16% of S&P AAA rated bonds that are downgraded to junk. Of the AAA ratings granted to RMBS in 2004, between 3% and 50% (depending on the type of RMBS) were downgraded to junk status. For securities rated AAA in 2005, the percentage downgraded rose from 39% to 81%. For 2006 vintage RMBS, between 81 and 98% of AAA rated RMBS were downgraded to junk. And for RMBS issued in 2007, over 90% became junk. According to the Senate Permanent Subcommittee on Investigations, "Perhaps more than any other single event, the sudden mass downgrades of MBS and CDO ratings were the immediate trigger for the financial crisis."

V. THE CALIFORNIA ATTORNEY GENERAL'S INVESTIGATION

19. As the crisis it helped create unfolded, S&P worked vigorously to conceal its wrongdoing. It denied that its ratings had become inflated or its business corrupted. Its executives publicly professed to be shocked that anyone could doubt the integrity of their company or its ratings.

20. However, incriminating documents eventually began to trickle out and whistleblowers came forward. The California Attorney General began investigating S&P's role in the massive losses inflicted on Californians who invested in structured finance securities. The California Attorney General's Office has devoted a team of dozens of attorneys, investigators, and auditors to uncovering the truth about what happened in the years leading up to the financial crisis. That team has conducted extensive witness interviews, issued dozens of subpoenas, and collected millions of pages of records.

VI. EVEN TODAY, S&P CONTINUES TO RESIST REFORM

21. Despite the investigations of the California Attorney General, the Securities Exchange Commission, the U.S. Senate, and others, S&P refuses to change its ways. For instance, in 2008, S&P hired two outside experts, Mark Adelson and David Jacob, in a public show of its commitment to clean up its rating business. To the dismay of top S&P executives, Adelson and Jacob tried to do just that: Adelson began tightening rating criteria and Jacob tried to restructure S&P's rating business to make it independent and immune from business pressure.

22. S&P's top executives soon tried to rein in Adelson and Jacob. S&P's president, Deven Sharma, called Jacob onto the carpet and "gave him hell" over lost business. After Jacob explained that the loss of business was in part due to Adelson's tighter criteria, Sharma pressured Jacob to do something about it, ordering him to consider "changing direction."

23. S&P held a leadership meeting in June 2011 with the theme "Relentlessly Driving Global Growth." Among the lessons S&P top executives sought to impart was that, "Success in criteria development depends on ongoing collaboration between the criteria group and the business." A case study presented at the meeting used the loss of business resulting from Adelson's criteria tightening as an example of the problems that can arise when the criteria group does not "collaborate" with business.

24. Adelson and Jacob still refused to "collaborate" or "change direction" as requested by their superiors. In December 2011, they were both replaced.

PARTIES

25. Attorney General Kamala D. Harris is the chief law officer of the State of California. She brings this action on behalf of the People of the State of California.

26. Defendant The McGraw-Hill Companies, Inc. ("McGraw-Hill") is a New York Corporation. McGraw-Hill is registered with the California Secretary of State to conduct business in the State of California. Throughout the Relevant Time Period, Standard & Poor's was a business unit within McGraw-Hill that conducted McGraw-Hill's credit rating business. It was not a separate corporate entity. McGraw-Hill is therefore directly liable for all of the misconduct described herein during the Relevant Time Period.

27. Defendant Standard & Poor's Financial Services LLC is a Delaware limited liability company registered with the California Secretary of State to do business in the State of California. It is a wholly-owned subsidiary of Defendant McGraw-Hill. It was formed on November 18, 2008 to house McGraw-Hill's credit ratings business as of January 1, 2009.

28. Standard & Poor's Rating Services is a business unit within Standard & Poor's Financial Services LLC. It operates as a credit rating agency that purports to analyze the creditworthiness of a particular company, security or obligation, including structured finance securities.

29. Plaintiff the People of the State of California are not aware of the true names and capacities of the defendants sued as Does 1 through 100, inclusive, and therefore sue these defendants by such fictitious names.

30. Each of these fictitiously named defendants is responsible in some manner for the activities alleged in this Complaint. Plaintiff will amend this Complaint to add the true names of the fictitiously named defendants once they are discovered.

31. The named and unnamed defendants in this action are collectively referred to as "Defendants."

32. Unless otherwise alleged, whenever this Complaint refers to any act of Defendants, such allegation shall mean that each Defendant acted individually and jointly with the other Defendants named in this Complaint.

33. Unless otherwise alleged, whenever this Complaint refers to any act of any corporate or other business Defendant, such allegation shall mean that such corporation or other business did the acts alleged in this Complaint through its officers, directors, employees, agents and/or representatives while they were acting within the actual or ostensible scope of their authority.

34. At all times relevant to this Complaint, each of the Defendants has acted as an agent, representative, or employee of each of the other Defendants and has acted within the course and scope of said agency, representation, or employment.

OTHER RELEVANT ENTITIES

35. PERS is the largest public pension fund in the United States. It provides retirement and health benefits to more than 1.6 million California public employees, retirees and their families. PERS's members include California firefighters, peace officers and other public employees.

36. STRS provides retirement, disability and survivor benefits for over 850,000 of California's prekindergarten through community college educators and their families. STRS, whose mission is to secure the financial future of California's educators, is the largest teachers' retirement fund in the United States.

37. PERS and STRS are arms of the State of California, operating under the California Constitution and the California Government Code. Pursuant to the California Constitution, the boards of PERS and STRS are bound by a "fiduciary responsibility for investment of moneys and administration of the [public pension] system."

JURISDICTION

38. This Court has jurisdiction to hear the claims alleged in this Complaint and is a court of competent jurisdiction to grant the relief requested.

VENUE

39. At all relevant times alleged in this Complaint, Defendants maintained an office and did business in the City and County of San Francisco.

40. Violations of law alleged in this Complaint occurred in the city and county of San Francisco.

PERS, STRS, AND OTHER INVESTORS PURCHASED STRUCTURED FINANCE SECURITIES IN RELIANCE ON S&P'S INTEGRITY AND RATINGS

41. PERS and STRS were among the largest institutional investors in structured finance securities during the Relevant Time Period. In reliance on S&P's ratings and integrity, PERS and STRS purchased large portfolios of structured finance securities, including but not limited to those listed on Appendix A.

I. STRUCTURED FINANCE SECURITIES PURCHASED BY PERS AND STRS

42. Structured finance refers to the process of securitizing the cash flow from an asset or pool of assets, typically loans or other debt instruments. A structured finance security is the financial product that results from this securitization. The most significant types of structured finance securities for purposes of this action, RMBS and SIV notes, are described below.

A. Residential Mortgage Backed Securities

43. RMBS are securities issued by a trust containing a pool of residential mortgages. The underlying mortgages serve as collateral for investors who purchase the securities. Payments by borrowers create the income received by RMBS investors.

44. The process of creating an RMBS begins when a financial institution, most often a bank, packages mortgage loans into a pool and transfers them to a trust that will issue securities collateralized by the pool. The trust purchases the loan pool and becomes entitled to the principal and interest payments made by the borrowers. The trust then uses payments from the borrowers to make monthly payments to the investors in the RMBS.

45. To appeal to investors with different risk appetites, the trust issues different classes of securities, known as "tranches," which offer a sliding scale of return rates based on the riskiness of the tranche. The tranches are typically arranged in a "waterfall" in which tranches at the top of the waterfall are paid first, tranches immediately below them are paid once the top tranches have received all their money, and so on. The bottom tranches only get paid if every tranche above them has been paid in full. The bottom tranches are the riskiest and receive the highest return rates in order to compensate their holders for the possibility that they might not be paid at all. The top tranches are the safest and therefore receive the lowest return rates.

B. Structured Investment Vehicles

46. Before they all imploded during the 2007-08 financial crisis, SIVs were special-purpose companies that held portfolios of long-term asset-backed securities and bonds. They financed these holdings by issuing short-term debt securities, such as commercial paper and medium term notes (collectively "Senior Notes") and mezzanine capital notes ("Capital Notes"). Because long-term assets typically earn higher returns than short-term securities, a SIV could

reap profits on the income spread between its assets and its liabilities, after subtracting management fees and other costs.

47. SIVs had relatively small capital cushions, so most losses on a SIV's assets were passed on to the SIV's investors. As a result, the SIV's notes were vulnerable to even small declines in the value of the asset portfolio held by the SIV.

48. SIV asset managers, who provided advice and support, actively managed a SIV's assets, meaning that they had the authority to purchase and sell within the limits outlined in the SIV formation documents. These asset managers also ran many structural tests, often daily, to determine whether the SIV possessed adequate capital, collateral, and liquidity. SIVs had a liability "waterfall" similar to RMBS: SIV equity (effectively the bottom tranche of a SIV) took the first losses, followed by junior, medium-term debt, and last, commercial paper and medium term notes.

49. RMBS and related securities called collateralized debt obligations ("CDOs") were among the largest classes of long-term assets held by the SIVs at issue in this case.

50. The process for creating a typical CDO was similar to that for an RMBS. Specifically, a sponsor created a trust or other special purpose entity to hold assets and issue securities. Instead of the mortgage loans that are held in RMBS pools, a CDO trust typically held debt securities such as corporate or municipal bonds, junior tranches of RMBS, or credit derivatives, such as equity tranches of other CDOs. The trust then used the interest and principal payments from the underlying debt securities to make interest and principal payments to investors.

II. S&P'S RATINGS PLAYED A KEY ROLE IN PERS'S AND STRS'S PURCHASES OF BILLIONS OF DOLLARS WORTH OF STRUCTURED FINANCE SECURITIES

51. S&P's ratings were highly material factors in PERS's and STRS's purchases of structured finance securities. S&P's ratings had a natural tendency to influence, and did influence, PERS's and STRS's decisions to buy structured finance securities during the Relevant Time Period, including but not limited to each of the securities listed on Appendix A.

52. PERS's and STRS's investment rules placed strict limits on their investments in securities that did not receive high ratings, as did the rules of the vast majority of institutional investors. These rules implicitly or explicitly required institutional investors to buy large quantities of AAA-rated securities.

53. Even in those portfolios where PERS and STRS could invest in securities that did not have high ratings, S&P's ratings were nonetheless material to the pension funds' purchase decisions. For instance, S&P typically received much more information about the securities it rated than PERS or STRS did. Further, S&P usually had substantially more time to evaluate these securities than PERS or STRS did. The pension funds often had only a few hours in which to review offering documents for a security before deciding whether to purchase it. By contrast, S&P generally had weeks to come up with a rating.

54. S&P's ratings were also highly material to PERS and STRS apart from the pension funds' reliance on them. A credit rating does more than simply measure the credit risk of a security; the rating also dictates the market for the security. Because the vast majority of institutional investors have rules requiring them to buy highly rated – often AAA – securities, the market for such securities is significantly larger and more liquid than the market for lower-rated securities. Thus, a security with an AAA from S&P will be worth substantially more than an identical BBB-rated security.

55. Further, S&P's representations about its integrity were also material to PERS and STRS. S&P played a central and trusted role in the structured finance market, rating well over 90% of the structured securities issued during the Relevant Time Period. Its ratings were one of the foundations on which that market was built. If market participants knew that foundation was flawed – that S&P had intentionally corrupted its rating process in order to win more fees from issuers and more market share from its competitors – they would have left the market before it collapsed.

S&P'S REPRESENTATIONS ABOUT ITS INTEGRITY AND RATINGS

I. S&P KNEW AND INTENDED THAT CALIFORNIA'S PENSION FUNDS AND OTHERS WOULD RELY ON ITS REPRESENTATIONS

56. For years, S&P engaged in a concerted campaign to convince investors such as PERS and STRS that it was a paragon of integrity and professionalism and that its ratings were reliable. An S&P executive summarized S&P's public facade while testifying to Congress in 2002: "Standard & Poor's credit ratings have gained respect because they are based on objective and credible analyses. . . . We are not a company's advocate. We're not their dis-advocate. We really don't care. We're there just to call it as we see it, as a third-party, objective, credible opinion. . . ."

57. S&P fully understood – and intended – the weight investors placed on its ratings. As its President testified in 2002, "the fundamental reason that Standard & Poor's and others' ratings have grown in importance in our capital markets is our long track record of providing independent, objective, and reliable opinions on creditworthiness." "We fully recognize the value that we add to the markets and understand that it rests on a platform of integrity, objectivity, and independence. . . . [A]ll our processes, our standards, our methodologies are geared to meeting the objectives of integrity, quality objectivity, credibility and independence."

58. As noted by the Senate Permanent Subcommittee on Investigations, "[b]ecause structured finance products are so complicated and opaque, investors often place particular reliance on credit ratings to determine whether they should buy them."

59. S&P not only made such representations publicly, it engaged in concerted private efforts to encourage large investors to rely on its expertise and ratings. For example, S&P sent analysts and executives on "road shows" in which they would visit PERS and other large investors to, among other things, promote S&P's ratings and other products, answer questions about their methodologies, and build relationships with investors.

60. S&P intended that government investors, including pension funds, would rely on its ratings of structured finance securities. In a February 16, 2007 publication called "25 Years of Credit: The Structured Finance Market's Accumulated Wisdom," S&P wrote that its ability to

assign ratings to RMBS "enabled conservative investors, such as pension funds and insurance companies, to gauge the risk of structured finance investments without tying up valuable resources by having to analyze the underlying assets themselves."

61. S&P knew and intended that issuers of securities would use its ratings to get PERS, STRS, and other investors to buy the rated securities. Accordingly, S&P repeatedly, consistently, and publicly proclaimed to investors and other participants in the financial markets that its credit ratings, including those of structured finance securities, were independent, objective, and based on a reliable rating process. Examples of those representations are listed below by subject matter.

II. S&P's Representations About Its Integrity And Competence

A. S&P Represented That It Would Not Succumb to the Conflict of Interest Inherent in Its Issuer Pays Business Model and Would Not Act as an Advisor on Securities It Rated

62. During the Relevant Time Period, credit rating agencies, including S&P, were paid billions of dollars by the same entities that issued the structured finance securities that the rating agencies were rating. Specifically, in exchange for providing credit ratings on structured finance securities, rating agencies charged the issuer a fee based on the complexity and size of the structured finance security being rated. This compensation model is commonly referred to as the "issuer pays" model.

63. S&P has conceded that the issuer pays model created a technical conflict of interest. However, S&P claimed to have internal controls to prevent the issuer pays model from impacting its ratings. S&P made these representations many times in many settings.

64. Section 3.1.5 of S&P's September 2004 Code of Practices and Procedures (the "Code" or "S&P Code") states: "Ratings assigned by [S&P] shall not be affected by an existing or a potential business relationship between [S&P] (or any Non-Ratings Business) and the issuer or any other party, or the non-existence of such a relationship." According to S&P, "the fact that [S&P] receives a fee from the issuer must not be a factor in the decision to rate an issuer or in the analysis and the rating opinion." (S&P Code § 3.1.2.)

65. S&P also assured the public that the role of issuers in the rating process would be limited, representing that S&P "shall not accept any qualitative or editorial revisions from issuers that affect the presentation of the rating." (S&P Code § 1.3.8.)

66. In a document formerly available on its website, "The Fundamentals of Structured Finance Ratings," S&P acknowledged that the "issuer pays" model could compromise its analysis but reassured investors by stating, "[w]e are intensely aware that our entire franchise rests on our reputation for independence and integrity. Therefore, giving in to 'market capture' would reduce the very value of the rating, and is not in the interest of the rating agency."

67. S&P's President, Leo C. O'Neill, represented to the SEC in 2003 that S&P was committed to protecting the ongoing value of its reputation and future as a credit rating business by ensuring the integrity, independence, objectivity, transparency, and credibility of its ratings. According to O'Neill, no single issuer fee or group of fees would be important enough to risk jeopardizing S&P's reputation and future.

68. In its public statements, S&P also assured investors that its role in the capital markets was limited to *rating* securities, not structuring them. For example, in section 1.1.5 of its Code, S&P stated that it "does not act as an investment, financial, or other advisor to, and does not have a fiduciary relationship with, an issuer or any other person. [S&P] does not become involved with the actual structuring of any security it rates, and limits its comments to the potential impact that any structuring proposed by the issuer may have on the rating."

B. S&P Represented That It Had Adequate Staffing and Resources to Provide Credible Ratings

69. S&P also continuously represented that it had the expertise and resources to evaluate complex securities and assign accurate ratings to them.

70. For example, in its 2004 annual report, McGraw-Hill touted S&P's purported ability to provide "investors with the independent benchmarks they need to feel more confident about their investment and financial decisions." McGraw-Hill's 2006 annual report stated, "[a]s financial markets grow more complex, the independent analysis . . . offered by [S&P is] an integral part of the global financial infrastructure." In its 2007 annual report, McGraw-Hill

claimed that S&P's "capabilities and expertise continue to expand to meet the complex demands of the global financial markets." McGraw-Hill also made similar representations in its 2006 and 2008 reports.

71. In its Code, S&P claimed that it would not issue a rating until all "appropriate analyses have been performed." (S&P Code § 1.2.1.) According to S&P, any rating conclusion had to be approved by a rating committee "utilizing [S&P]'s established criteria and methodologies." (S&P Code § 1.3.3.)

72. S&P publicly detailed its processes and procedures for arriving at reliable and consistent ratings. S&P claimed that it employed "specific credit analysis factors to ensure that all relevant issues are considered during the credit rating and surveillance processes." (S&P Code § 1.7.1.) S&P represented that "[i]n order to maintain consistency of ratings," S&P's Analytics Policy Board would be responsible for "monitoring the quality of, and adherence to, the rating definitions, criteria, methodologies, and procedures and for approving any significant changes to the rating definitions, criteria, methodologies and procedures." (S&P Code § 1.7.3.)

C. S&P Represented That It Monitored Securities After Rating Them to Ensure That They Continued to Deserve Their Ratings

73. S&P also publicly promoted the robust and reliable nature of its rating surveillance processes.

74. S&P promised that it would "monitor the rating on an ongoing basis . . . in accordance with a surveillance policy established by [S&P]. The Chief Credit Officer and the Analytics Policy Board shall be responsible for overseeing and reviewing [S&P]'s surveillance policy and for ensuring that the surveillance policy results in credible credit ratings." (S&P Code § 1.4.1.)

75. Section 1.9 of S&P's 2005 Code of Conduct states: "[O]nce a rating is assigned [S&P] shall monitor on an ongoing basis and update the rating by: (a) regularly reviewing the issuer's creditworthiness; (b) initiating a review of the status of the rating upon becoming aware of any information that might reasonably be expected to result in a Rating Action (including

withdrawal of a rating), consistent with the applicable rating criteria and methodology; and, (c) updating on a timely basis the rating, as appropriate, based on the results of such review."

III. S&P's Representations Regarding Its Ratings

A. S&P's Ratings Scale

76. Throughout the Relevant Time Period, S&P's ratings of structured finance securities took the form of a letter grade rating. Ratings AAA, AA, A, BBB, BB, B, CCC, CC, C, and D had less creditworthiness with each succeeding reduction in grade level.

77. According to S&P, AAA-rated securities should, on average, be able to withstand the economic conditions of the Great Depression.

78. S&P could also modify its ratings between AA and CCC by attaching a plus (+) or minus (-) sign to show the relative standing within the major rating categories.

79. S&P described its ratings in the following way:

AAA: Extremely strong capacity to meet financial commitments. Highest rating.

AA: Very strong capacity to meet financial commitments.

A: Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.

BBB: Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.

BBB-: Considered lowest investment grade by market participants.

80. S&P also provided credit ratings on short-term issues (generally, issues with maturities of one year or less, such as commercial paper) on a scale from A-1+ to D. An A-1+ rating indicated that the issue's capacity to meet its financial commitments was extremely strong.

B. General Overview of S&P's Rating Process

81. Within S&P's Structured Finance division, ratings analysts were assigned to rate a proposed deal based on their specialization in that type of deal.

82. Based on their analyses, S&P's ratings analysts developed a recommendation for a final credit rating for each class of securities issued as part of the deal. The recommendation was presented to an internal S&P ratings committee made up of senior analysts and/or ratings analytical managers, for final approval. The committee was charged with considering relevant

information and applying appropriate criteria and methodologies. At the rating committee meeting, pertinent information and a rating recommendation were presented and discussed. Then the committee voted on the recommendation.

83. After S&P issued a rating on a security, the rating was transferred to the S&P Surveillance Group within Structured Finance for monitoring. The Surveillance Group and S&P's internal rating committee for each structured finance category were responsible for monitoring the rated security.

1. Overview of S&P's RMBS rating process

84. In addition to the process and criteria applied in rating all structured finance deals, S&P used a model called Loan Evaluation and Estimate of Loss System ("LEVELS") to rate RMBS offerings. LEVELS was a statistical computer model that evaluated the overall creditworthiness of a pool of mortgage loans underlying an RMBS transaction. Using LEVELS, S&P analyzed each mortgage loan's characteristics, such as equity, loan type, income verification, whether the borrower occupies the home, and the purpose of the loan.

85. According to Frank Raiter, the Managing Director of S&P's Residential Mortgage Rating Group from 1995 until 2005, the accuracy of the LEVELS model was critical to the quality of ratings. The accuracy of LEVELS depended on the quality and quantity of loan data collected and analyzed by S&P. Each new version of LEVELS was built with growing data on traditional as well as new mortgage products. That is why, until the early 2000's, each version of the model was better than its predecessor in determining default probabilities.

2. S&P's SIV rating process

86. During the Relevant Time Period, S&P represented to investors that the touchstone of its SIV ratings was a defeasance analysis: S&P would determine whether the senior debt of the SIV would remain AAA/A-1+ rated until the last senior obligation had been honored in case the SIV needed to be wound down. In other words, to be confident that a SIV's senior liabilities were able to maintain the highest possible ratings until maturity, S&P said that it measured the SIV's capital adequacy by assuming that the SIV entered into immediate wind-down, sometimes referred to as "defeasance" or "enforcement." Thus, according to S&P, it based its analysis on

the following question: If the SIV enters into defeasance or enforcement today, can it repay all its senior liabilities as they come due by selling its assets? If – and only if – the answer to that question was 'yes' in virtually any conceivable circumstance, the SIV could receive an AAA/A-1+ rating.

87. S&P represented that it analyzed whether, in all of the SIV's operating states, the credit, market, liquidity, hedging, and operational risks were covered to an AAA level – meaning that the SIV would be able to pay all of its senior liabilities in any foreseeable situation.

88. S&P also provided "capital matrices" to determine the base minimum amount of capital allowed before a SIV would be required to operate in a more conservative way. These operating instructions were themselves based on the ratings of the assets that the SIV would acquire. Each time the SIV selected a potential investment to be acquired, it would determine the weighted average life of the asset, its credit rating, and the asset class – such as non-prime mortgage-backed securities – from which the investment is drawn.

89. Based on these parameters, on an asset-by-asset basis, a SIV would set aside a predetermined amount of capital for the protection of the Senior Notes and Capital Notes and the preservation of their respective ratings. The percentage of capital required was negotiated in advance with S&P.

90. S&P also represented that it stress tested CDOs, a major component of the portfolios held by many SIVs – including those at issue in this case. S&P used a model called CDO Evaluator to rate CDOs. The heart of the Evaluator model was a "Monte Carlo" simulation of defaults with correlations, to estimate default rates for different asset pools in CDO deals. S&P claimed that the simulation tested CDOs against every conceivable economic scenario.

91. During the Relevant Time Period, documents describing the SIVs and S&P's criteria for rating them were distributed or made available to investors, including PERS's investment managers. These documents included the key terms of each SIV's rated Senior Notes and Capital Notes as well as representations that the Senior Notes would be rated AAA/A-1+ by S&P, and that the SIV itself was AAA.

92. The AAA/A-1+ ratings assigned to the senior liabilities of all of the SIVs were S&P's highest long- and short-term rating categories. S&P also provided counterparty credit ratings of AAA/A-1+ for all the SIVs it rated.

93. S&P also represented to investors that it regularly and systematically monitored and cross-checked the performance of each SIV's asset portfolio. To check that a SIV had sufficient capital, its portfolio was to be monitored on a daily basis by marking to market each asset in the portfolio. Thus, any asset trading below par would have an impact on the net asset value of the SIV and the level of capital that it might require to maintain an AAA rating. Market prices had to be provided by pricing sources approved by S&P. In addition to monitoring the SIVs' asset prices and performance, on an ongoing basis, S&P received extensive weekly reports from the SIVs to fully survey all operating guidelines, liquidity levels, and other aspects of the SIVs.

94. Unlike the investors in the SIVs, S&P had an ongoing involvement in the SIV transactions and played an integral role in monitoring each SIV's covenants and covenant breaches. S&P was also involved in approving substitutions and changes to the SIVs' asset portfolios.

ALL OF S&P'S REPRESENTATIONS WERE KNOWINGLY FALSE

95. S&P's representations about its integrity, competence, and the quality of its ratings were knowingly false. Specifically, S&P made each of the above representations with actual knowledge that it was false, in reckless disregard of its truth or falsity, or in deliberate ignorance of its truth or falsity. Further, each individual speaker was authorized to speak on behalf of S&P when he or she made the misrepresentations at issue.

96. In reality, S&P intentionally corrupted both its ratings and its later surveillance of those ratings. That corruption took many and complex forms, some of which affected only one class of securities and some of which affected all classes. But a consistent theme ran through all of S&P's misdeeds: S&P would do anything to maximize its market share and profits. As one S&P senior executive later put it, S&P "felt more like the Wild West," and tightening rating criteria "puts a crimp on the business."

97. The Senate Permanent Subcommittee on Investigations concluded that S&P corrupted its ratings a number of ways:

> The ratings agencies weakened their standards as each competed to provide the most favorable rating to win business and greater market share. The result was a race to the bottom. Additional factors responsible for the inaccurate ratings include rating models that failed to include relevant mortgage performance data, unclear and subjective criteria used to produce ratings, a failure to apply updated rating models to existing rated transactions, and a failure to provide adequate staffing to perform rating and surveillance services, despite record revenues.

98. S&P's top managers knew it was wrong to do these things. In the words of one senior managing director at S&P, "I knew it was wrong at the time. It was either [weaken our criteria] or skip the business."

99. A July 2004 Criteria Memo updated S&P's email policy purportedly to promote the "robust exchange of ideas and opinions among committee members." The policy discouraged email communications among those involved in the rating committee process and required that all ratings committee work be done in person or by phone. The email policy further stated:

> Second-guessing or revisionist history concerning a particular rating decision that was reached in accordance with Standard & Poor's policies and procedures is inappropriate behavior irrespective of the method of communication chosen. Similarly, commenting on rating decisions in which you were not directly involved or have sufficient knowledge of is inappropriate.

Despite this policy, many emails, including those discussed below, confirm S&P's wrongdoing as well as the conclusions reached by the Senate and the allegations in this Complaint.

100. S&P's representations at issue in this action connoted actual, objectively verifiable facts. S&P neither genuinely nor reasonably believed these representations, and the representations were without basis in fact. S&P had knowledge of facts that contradicted its representations and lacked knowledge of facts to support them. S&P did not genuinely, honestly, or reasonably entertain beliefs or "opinions" included in or implied by their representations. Further, S&P had knowledge and information superior to that of investors, including PERS and STRS, regarding the subjects of those representations. S&P's representations, including matters they implied, did not reflect its actual beliefs. Further, S&P's statements knowingly omitted facts tending to seriously undermine the accuracy of the statements.

101. S&P's representations were deliberate affirmations of the matters stated, rather than just causal expressions of belief. S&P's representations implied certainty as to matters stated or implied. S&P possessed or held itself out as possessing superior knowledge or special information or expertise regarding the subject matters of its representations. Investors, including PERS and STRS, were situated so that they could and would reasonably rely on S&P's supposed knowledge, information, and expertise.

I. Reasons False as to All Securities

A. S&P Weakened Its Rating Criteria in a Race to the Bottom with Moody's

102. Deviating from its public promises, S&P inflated its ratings in a race to the bottom with Moody's. This contradicted the claim in S&P's 2005 Code of Conduct that it "ensures that the integrity and independence of [its rating] processes are not compromised by conflicts of interest, abuse of confidential information or other undue influences."

103. S&P's global marketing strategy, circulated to top S&P executives, left no doubt that "[p]rotecting our turf means everything to us in 2006."

104. S&P was explicitly concerned about matching Moody's rating methods, regardless of rating quality. As explained by Kai Gilkes, an S&P managing director of quantitative analysis at the time, analysts were encouraged to loosen criteria:

> The discussion tends to proceed in this sort of way. "Look, I know you're not comfortable with such and such assumption, but apparently Moody's are even lower, and if that's the only thing that is standing between rating this deal and not rating this deal, are we really hung up on that assumption?"

105. Illustrating Gilkes' point, a May 2004 internal S&P email addressed to Joanne Rose, the former head of Global Structured Finance, stated that "[w]e just lost a huge . . . RMBS deal to Moody's due to a huge difference in the required credit support level . . . [which] was at least 10% higher than Moody's. . . . I had a discussion with the team leads here and we think that the only way to compete is to have a paradigm shift in thinking."

B. S&P Loosened Its Rating Criteria Process for All Asset Classes to Serve Its Market Share Goals

106. The spreading corruption of S&P's rating process was not confined to any particular type of structured finance asset class. Instead, the desire to please issuers tainted the development of rating criteria and proposed changes to rating criteria in each of the practice groups within Structured Finance, including RMBS, CDOs, CMBS, and asset-backed securities ("ABS"). PERS and STRS invested in these types of assets, including those comprising the SIVs.

107. Under the "issuer pays" model, S&P depended upon Wall Street firms to bring it business, and catered to threats that the firms would take their business elsewhere if they did not get the ratings they wanted.

108. Thus, S&P placed a "For Sale" sign on its reputation by March 20, 2001, according to former S&P executive Frank Raiter. On that date, in a harbinger of the collapse of S&P's RMBS rating standards, S&P's highest management ordered a credit rating estimate even though S&P lacked vital loan data to perform the necessary analysis. This resulted in the "most amazing memo" Mr. Raiter had "ever received in [his] business career." When Mr. Raiter requested the necessary loan level data, Richard Gugliada, the head of S&P's CDO group at the time, rejected the request, stating:

> Any request for loan level tapes is TOTALLY UNREASONABLE!!! … Furthermore, by executive committee mandate, fees are not to get in the way of providing credit estimates.... It is your responsibility to provide those credit estimates and your responsibility to devise some method for doing so.

109. Both Mr. Gugliada and Mr. Raiter later confirmed that providing a credit rating estimate without the necessary data was tantamount to a "guess" which was "by S&P's management policy, approved by the structured finance leadership team."

110. S&P's choice to mirror Moody's rating results made it vulnerable to "rating shopping." For example, in May 2006, an S&P Client Value Manager received an email from an investment banker questioning moderate criteria changes in S&P's RMBS ratings model:

> heard you guys are revising your residential mbs rating methodology – getting very punitive on silent seconds. heard your ratings could be 5 notches back of mo[o]dys [sic] equivalent. gonna kill your resi biz. may force us to do moodyfitch only cdos!

111. In response, the managing director for RMBS Client Value Managers confirmed to S&P's senior executives, that S&P would rate deals based on how Moody's rated deals:

> [T]o say that these changes will leave us 5 notches back of Moody's sounds like a gross over statement, especially since we have been a notch or two more liberal then [sic] they have been (causing the split rating issues) for over the last year or two. The simulations that we did on the impact of our changes, more often then [sic] not we believe will bring our requirements close to theirs or in certain situations slightly higher. We certainly did [not] intend to do anything to bump us off a significant amount of deals.

112. In another early example of S&P's race to the bottom, by 2003, S&P already knew that its rating criteria for CDOs were "random." Thus, in response to an email discussing S&P's assignment of analysts to work on CDO deals, Dr. Frank Parisi, an S&P Director heavily involved in the modeling efforts, emailed the head of S&P's Criteria group, and other S&P managers, describing how S&P relies on "the 'Random *Criteria* Generator' they use to rate deals which allows them to rate anything that walks through the door and have surveillance clean it up later." (Original emphasis.) By using "random criteria" to help issuers, S&P harmed investors who relied on ratings not knowing that they were based on "random" criteria.

113. By July 12, 2004, S&P had decided to ignore its public claim that "[r]atings assigned by [S&P] shall not be affected by an existing or potential business relationship between [S&P] (or any Non-Ratings Business) and the issuer or any other party, or the non-existence of such a relationship."

114. Rather, S&P's new Global Structured Finance Criteria Process, circulated to S&P's top managers in July 2004, and authored by senior executives Joanne Rose and Tom Gillis, explicitly tied rating criteria to business relationships. It did so under the euphemism "market appropriateness." The process of changing or adopting new criteria also required a new explanation of "[d]esired [o]utcome," where the "proposal should indicate what influence the adoption of the criteria will have on default rates, rating volatility, and market perception and reaction."

115. This new market-focused process was challenged in 2004 – to no avail. For example, Mr. Raiter – outraged at this new practice – emailed senior executives that "we NEVER

poll [investors, issuers, and investment bankers] as to content or acceptability!" (Original emphasis.) Mr. Raiter added:

> What do you mean by "market insight" with regard to a proposed criteria change? What does "rating implication" have to do with the search for truth? Are you implying that we might actually rate or stifle "superior analytics" for market considerations?

116. Mr. Raiter also testified that until the Criteria Process proposal in July 2004, his group had never incorporated concepts of "market insight" into development of criteria. He explained that such considerations impinged on S&P's independence and "didn't have any relevance" to S&P decisions about developing or implementing new criteria. He also testified that seeking market perspective for criteria development was "absolutely not the right thing to do" because it interfered with S&P's independence. In addition, Mr. Raiter could not see why Client Value Managers (essentially salespeople) should be consulted when developing new criteria. S&P rejected Mr. Raiter's concerns.

117. In this "Wild West" atmosphere, rating criteria were routinely loosened for business reasons. In August 2004, for example, Ms. Scott, the S&P executive in charge of CMBS, emailed the head of Structured Finance and other high level managers, saying that "[w]e are meeting with your group this week **to discuss adjusting criteria for rating CDOs of real estate assets this week because of the ongoing threat of losing deals**." (Original emphasis.) This, according to Richard Gugliada, the former managing director of the CDO group, led to S&P lowering its criteria to accommodate clients. According to Mr. Gugliada, by 2006 S&P had repeatedly eased its rating standards in "a market-share war where criteria were relaxed." Mr. Gugliada also admitted that: "I knew it was wrong at the time. It was either that or skip the business."

118. Further, Mr. Gugliada explained that when the subject of tightening S&P criteria did come up, the co-director of CDO ratings, Dave Tesher, said: "don't kill the golden goose."

119. Members of the Structured Finance Leadership Team ("SFLT") also knew of the corruption of S&P's criteria process. Minutes of an off-site SFLT meeting in London in July

2006 noted that analysts were afraid of losing business if criteria changed and that different offices within S&P applied S&P's July 2004 Criteria Process differently, causing more confusion.

120. In another example of S&P's willingness to bend criteria as needed to win deals, the head of S&P's Global ABS and RMBS Groups in 2004 acknowledged that "flexible criteria" were a tool to help raise ratings to gain market share. In a June 2004 Activity Report to the head of the SFLT, Pat Jordan explained how S&P lost two large Japanese RMBS deals because Moody's heavily undercut its required credit support (a key rating criterion) levels. So, S&P lowered its own rating criteria to compete with Moody.

121. In other words, as another S&P analyst had warned in a June 2005 email to senior managers, "[s]crewing with criteria to 'get the deal' is putting the entire S&P franchise at risk -- it's a bad idea." Yet, S&P did so repeatedly.

II. S&P SUPPRESSED NECESSARY UPDATES TO ITS RMBS LEVELS MODEL TO PRESERVE MARKET SHARE

122. S&P represented to the public that its "capabilities and expertise continue to expand to meet the complex demands of the global financial markets." This was false. The truth was that S&P deliberately allowed its RMBS rating model, known as LEVELS, to become obsolete because updating the model would have cost money and market share. S&P's suppression of updates to its RMBS rating model was an important factor responsible for its inaccurate ratings of RMBS.

123. According to Mr. Raiter, until 2001 S&P's top management had approved and funded updates and improvements to the LEVELS model, as well as loan data collection and analysis. However, after 2001 S&P's top management refused to provide the funding and staff needed to continue developing LEVELS to keep up with rapid growth and changes in the RMBS market.

124. As early as 2004, S&P's own internal analysis of its LEVELS model revealed that it needed updating because it failed to account for the explosive growth of RMBS. It was also underestimating the risk of some ALT-A and subprime mortgages, which are loans made to less credit-worthy borrowers. However, S&P management denied staff budget requests for funding to

update the LEVELS model. When pressed, S&P management claimed, in part, that it lacked the resources for these updates – even though S&P was earning record profits. S&P senior managers also refused to allocate more resources if doing so would not increase S&P's already high market share.

125. Even though S&P refused to adequately fund the updating of LEVELS, by 2004 S&P's RMBS rating group had developed, tested and recommended using an updated "complete" version of its LEVELS model called LEVELS 6.0. One component of the updated version allowed for more accurate estimates of the amount of loss if mortgage loans were to default. The "complete" version of LEVELS 6.0 included a new equation called the "MTI equation" to better estimate the probability of default of mortgage loans. The MTI equation was derived from an additional data set of 640,000 mortgage loans.

126. In July 2004, S&P testing of the complete version of LEVELS 6.0 showed that the fully updated model would substantially lower ratings on many types of RMBS, including Prime, nonprime (including subprime), Alt-A, and with some changes, would also lower Adjustable Rate Mortgage ("ARM") and balloon loan ratings. The RMBS rating group recommended releasing the complete version of LEVELS 6.0 by August of 2004 – but S&P management refused to authorize the use of LEVELS 6.0 for nearly three more years.

127. Dr. Parisi, a Director in S&P's RMBS rating group deeply involved in developing the RMBS rating models, explained in a March 23, 2005 email to several senior and managing directors: "When we first reviewed [LEVELS] 6.0 results **a year ago** we saw the sub-prime and Alt-A numbers going up and that was a major point of contention which led to all the model tweaking we've done since. Version 6.0 could've been released months ago and resources assigned elsewhere if we didn't have to massage the sub-prime and Alt-A numbers to preserve market share." (Original emphasis.) In response, an RMBS Client Value Manager acknowledged that he had influenced S&P's decision to delay releasing LEVELS 6.0, directly contravening S&P's representations about its rating process.

128. S&P not only failed to implement LEVELS 6.0 in 2004, it also ignored another proposed improved model, LEVELS 7.0, first proposed the same year. Although LEVELS 6.0

would have been an improvement over the version of LEVELS in effect in 2004, it would not have fully captured the risk of all non-conforming loans. As a result, S&P's RMBS rating group had also taken significant steps towards developing LEVELS 7.0, which would have been based on new variables. LEVELS 7.0 would also have incorporated an updated MTI equation based on 2.8 million loans.

129. S&P's Executive Committee and senior management were told in late 2004 that LEVELS 7.0 would have been "by far the most robust model." Among other upgrades, it would have improved upon LEVELS 6.0 by adding High LTV and second mortgages including, home equity loans ("HEL"), Home Equity Line of Credit ("HELOC") and closed end seconds – all assets contained in RMBS that PERS or STRS invested in. However, S&P management refused to implement LEVELS 7.0.

130. S&P also failed to use loan data it already had, or to acquire more loan data that was readily available, to ensure accurate ratings. Mr. Raiter testified that when he retired from S&P in early 2005, S&P had a hard drive with almost 10 million more loans that could have been used to improve S&P's loan ratings, but were not.

131. It was not until March 2007 that S&P management finally allowed a watered-down LEVELS 6.0. Even then, it was only effective starting with deals rated in May 2007. Compounding the harm from the delay, S&P management only permitted the use of the incomplete version of LEVELS 6.0 - without the MTI equation — not the more robust "complete" version of LEVELS 6.0.

132. Even further compounding the harm, data that was valid for the rising housing market of 2004 was obsolete by 2007, when the housing market had peaked. Thus, the incomplete version of LEVELS 6.0 released in 2007 was already obsolete and inadequate.

133. Due to these flaws, the released version of LEVELS 6.0 was little better than "a coin toss" for rating Prime, Alt-A and subprime RMBS, as shown in an April 2007 study by an S&P Director who helped develop LEVELS versions 6.0 and its predecessors. That was not an off-the-cuff opinion, but one reached after studying the predictive power of the released version of LEVELS 6.0.

134. Former S&P Managing Director Frank Raiter further testified that ". . . if S&P had vigorously pushed to implement [the LEVELS model] based on the 2.8 million loan data set in later 2004 or early 2005, the economics of deals incorporating the lowest quality subprime and Alt-A loans would have disappeared."

135. S&P's concerns about keeping and growing its market share trumped implementing updated LEVELS models recommended by its ratings group. Those models would have accounted for the higher risks associated with the increase in subprime and Alt-A loans of RMBS transactions – but that was not S&P's goal. S&P did not want to increase the accuracy of its models if doing so would decrease its profits or market share. As a result, rather than spend the necessary funds to implement LEVELS 6.0 in 2004, S&P's management sought to "massage" the subprime and Alt-A numbers to continue to rate offerings and not lose market share.

A. S&P Used "Magic Numbers" and Guesses to Rate Deals for the Sake of Maintaining RMBS Market Share

136. As discussed above, following 2001, S&P's RMBS group knew that LEVELS was inaccurate, but S&P refused to make it accurate because accurate ratings would hurt business. Its solution to this dilemma was again to use guesswork: making up key numbers as part of LEVELS to further justify inflated RMBS ratings.

137. In early 2005, rather than implement LEVELS 6.0, S&P applied "magic numbers" to its outdated version of LEVELS. As Mr. Raiter later testified:

> A lot of the adjustments that were made to the -- to the [LEVELS] model, in 2005 and `6, as it was pointed out in some of your exhibits, were, in fact, variables or multiples applied to existing output to change those numbers. And when they referred, in Frank Parisi's e-mail, to massaging the data so that you got answers that weren't as extreme as the modeling analysis suggested, that was accomplished with magic numbers.

138. In another example of arbitrary numbers, in an internal February 8, 2006 email, an S&P employee described to senior RMBS managers how he manipulated payment dates in LEVELS to try to improve the rating of an RMBS to satisfy the issuer: "I changed the first payment date for all loans that were seasoned 5 years or greater back to their original date so they would receive credit in LEVELS (approx 17.4% of total pool balance). The net effect was not as

great as expected." In response, an S&P senior director condoned the method and wrote: "I don't think this is enough to satisfy them. What's the next step?"

139. S&P also "tweak[ed]" its LEVELS model to maintain "minimal business disruption" which was a euphemism for preserving its market share. The focus was on business, not the model's accuracy. For example, in April 2006, an S&P analytical manager in the US RMBS sector admitted that, ". . . for LEVELS the 'better' model choice will be driven more by consistency and minimal business disruption than by model performance measures. From past experience this is a give and take -- so we may find the model 'makes sense' for some asset classes but not others, and we can tweak those cases where we need it to satisfy the business concern."

140. Thus, not only did S&P use outdated models, but it also improperly modified the actual economics of the underlying assets to accommodate issuers.

B. S&P Further Corrupted Its Ratings Process for RMBS Comprised of HELOC and ARM Securities

141. Besides knowingly relying on the obsolete LEVELS model riddled with "magic numbers," S&P also compromised its ratings of HELOC and ARM securities by using unsound Constant Prepayment Rates and loss calculation methods. PERS and STRS invested in these securities as well.

142. Constant Prepayment Rate ("CPR") was another critical component of rating RMBS, including RMBS made of HELOC and ARM loans. CPR measured the rate (or speed) at which borrowers prepaid loans ahead of schedule. Accurate cash flow calculations to support accurate ratings for HELOC and ARM securities required accurate estimates of the CPRs for the underlying mortgage loans. However, the credit performance of a loan pool depended on the *type* of loans each pool contained (e.g., prime, Alt-A, and subprime). Each loan type had its own characteristics and risks concerning expected losses and loan prepayment behavior. Lower risk prime borrowers might have higher prepayment rates than riskier subprime borrowers. Yet S&P's rating methods failed to capture the differences in CPRs arising from the different prepayment ability of such borrowers. S&P was aware of the need to have accurate CPR criteria

for accurate RMBS ratings as early as 2001, yet – as with other criteria – chose not to update its RMBS rating methods.

143. By October 2003, S&P's Criteria Committee was informed that S&P calculated HELOC CPR using an approach that was "not analytically sound." S&P's practice was to erroneously assume that HELOCs simply paid at the same rate as subprime mortgages. S&P also knew that it did not yet model HELOCs and would need to either include HELOCs in LEVELS or create a new model. No action was taken during this time, or even by July 2004, when a key S&P rating model analyst warned RMBS managers of her belief that CPR speeds were "going to dramatically rise" on HELOCs. In August 2004, another rating RMBS rating analyst again warned senior RMBS management of the need to "develop sensible CPR curves."

144. As early as January 2002, directors in the RMBS group responsible for LEVELS were also provided an equation to better model HELOC losses under stressful scenarios as part of LEVELS. Yet as of April 2005, S&P still had not included the HELOC equation – even though the head of RMBS and others were informed that S&P's failure to implement the HELOC equation of January 2002 "[did] NOT bode well." (Original emphasis.) Despite knowledge of the modeling problems for HELOCs, S&P did not act until 2008, when it finally included a HELOC component with the release of LEVELS 6.3.

145. Further, high-level S&P managers were aware in June 2006 that CPRs also posed a problem for rating securities based on ARMs. Internally, S&P had serious concerns about CPRs and was "worried that this is going to blow up in our faces." Specifically, S&P analysts writing an article on CPRs were instructed by Tom Warrack, Managing Director of Client Value Managers, to "[c]hange the introduction of the article from saying that S&P expects slower CPRs in the future, to explaining why prepayments haven't slowed and mention what economic events would need to transpire in order to slow down prepayments." This caused the analyst to email that "Tom is being very reckless and I'm worried that this is going to blow up in our faces."

C. S&P Also Suppressed and Stalled Updates to Its CDO Rating Model and Related Criteria

146. No later than 2005, S&P management knew that its CDO Rating Model, CDO Evaluator, needed updating, and that the version in effect in December 2005 included "outdated assumptions."

147. After reviewing voluminous evidence and hearing days of testimony, the chair of the Senate Permanent Subcommittee on Investigation concluded that S&P intentionally delayed implementing a new version of CDO Evaluator:

> In the summer of 2005, S&P had revamped its CDO model, but put the model on hold for more than a year, as it struggled to rationalize why it would not use the new model to retest existing CDO securities. It is clear from over a year of internal emails that S&P delayed and delayed the decision, anticipating that the revised model would require existing CDO securities to be downgraded, disrupt the CDO market, and reduce public confidence in its CDO ratings. It would have also disrupted S&P profits from CDO ratings.

148. S&P quantitative analyst Kai Gilkes wanted a CDO model that would produce more accurate ratings. However, his recommendations to update the CDO model were rejected due to S&P's concerns about how the revisions would affect S&P's existing ratings, the market, and S&P's place in the market.

149. S&P also repeatedly yielded to pressure from CDO issuers to grant an "accomodat[ion]" if a proposed deal did not pass under the CDO Evaluator model. An "accomodat[ion]" made one time often turned into further exceptions down the road. In August 2006, for example, an S&P managing director and Client Value Manager admitted to an issuer seeking more exceptions, "[h]ow many times have I accommodated you on tight deals?," noting too that the issuer had also pressured another S&P employee to do the same.

150. In 2005, S&P senior managing directors "toned down and slowed down" the release of CDO Evaluator 3.0 because it would drive away business. One of S&P's major clients, Bear Stearns, had complained to S&P that CDO Evaluator 3.0 "would not be conducive towards rating low credit quality pools." According to a July 2005 memo from Pat Jordan to Joanne Rose, the head of Structured Finance, "Bear Stearns pointed out that the potential business opportunities we would miss by effectively having to walk away from such high yield structures would NOT be

compensated for by any increases in rating volume for highly rated collateral pools." (Original emphasis.) The memo continued, that as a result, S&P had "toned down and slowed down [its] roll out of E3 to the market, pending further measures to deal with such negative results."

151. Mr. Gugliada later confirmed that he and David Tesher both resisted CDO Evaluator updates because they would have had a significant negative effect on S&P's market share and ratings business.

D. S&P Diluted Its CDO Evaluator Model to Expand Its Market Share

152. Even when S&P developed an updated CDO Evaluator model, S&P deliberately used a diluted version of the model so as not to disrupt its business. This version was known as the "E3 low" model.

153. In June 2005, in an email to S&P analyst Michael Drexler, an S&P analyst Kai Gilkes lamented the corruption of the CDO model, instead of properly updating the model, stating:

> Remember the dream of being able to defend the model with sound empirical research? The sort of activity a true quant CoE should be doing perhaps? If we are just going to make it up in order to rate deals, then quants are of precious little value.

154. Yet, S&P was unwilling to update these models fully because market sentiment about these improvements was "scary," according to Mr. Drexler.

155. In addition, fears of the impact on already rated deals stifled even discussion of improving S&P's CDO rating process. According to Mr. Drexler in the June 2005 email above, "the surveillance question" (i.e., whether and how to apply an improved CDO model to previously rated deals) continued to "haunt the dreams of NY management" to such a degree that Tom Gillis, the chief criteria officer for S&P was "pissed" and "refuses to accept any of the surveillance proposals." Three months later, the head of the Global CDO group instructed her staff that testing of CDO Evaluator 3.0 should not begin until the surveillance question was answered.

156. The improvements Mr. Gilkes had inquired about included a long delayed update of Genesis. Genesis was used with Evaluator for rating cash flow CDOs. Genesis consisted of an

Excel spreadsheet built several years before, which according to a 2005 description of S&P's CDO Business suffered a number of "shortcomings/gaps" including "not comply[ing] with technology standards," and required "complete rebuilding."

157. In October 2005, the head of S&P's strategic planning group, Henry Carrier, directed his staff not to circulate an analysis of the problems with S&P's CDO's rating models. That analysis described one CDO process as "a crude patch," criticized the "poor integration" of CDO Evaluator and Genesis, and concluded that it was "readily apparent that we do not have the data or systems in place to be able to conduct large scale analysis in a timely manner." Inefficiencies and delays from implementing these proposed improvements further prolonged the corruption of the CDO ratings and surveillance processes.

158. Mr. Wong – a CDO Client Value Manager - later characterized the continuing corruption of S&P's CDO model in unmistakable words: "Lord help our f**king scam."

E. S&P Applied Fanciful Correlation and Related Criteria to Keep Ratings High

159. Asset correlation is one of the key factors that determines the credit rating of most structured finance securities. Correlation measures how assets in a structured finance security perform together. For example, in rating CDOs, a correlation of 0% indicates that there is no connection between the risk that one loan in a pool will default and the risk that another will. Put differently, a correlation risk of 0% means each asset can be measured in isolation and the default of a single asset does not change the overall riskiness of the pool. By contrast, a correlation of 100% between two assets means that if one asset performs poorly there is a 100% chance that the other one will too.

160. Other things being equal, the lower the correlation between the underlying assets of a structured finance security, the less risky that security is — and the higher rating it should receive. S&P deliberately avoided using accurate correlation assumptions to appease security issuers, and thus boost S&P's revenue. Rather than providing "investors with the independent benchmarks they need to feel more confident about their financial and investment decisions,"

S&P intentionally gave them unreliable benchmarks by, for example, using inaccurate correlation assumptions to give investors a false confidence in the securities peddled by S&P's clients.

161. For example, in February 2005, trying to argue for more rigorous correlation assumptions, "compared to the shenanigans" before then, one S&P analyst pointed out that "[b]oth [Moody's and S&P] are wrong: The historical data also shows us definitively that correlation is not static, as our modeling suggests, but changes dynamically (i.e. increases in times of stress)." Another analyst resisted, responding "I don't want to miss one deal because of our model assumptions."

162. On March 20, 2006, a senior managing director of another company warned a senior director at S&P that "I mentioned to you a possible error in the new [CDO] Evaluator 3.0 assumptions: Two companies in the same Region belonging to two *different* local Sectors are assumed to be correlated (by 5%), while if they belong to the *same* local Sector then they are *un*correlated. I think you probably didn't mean that." Two months later, the outside director followed up again with S&P. Finally, an S&P director admitted even though there may be a problem with S&P's correlation assumptions, the issue would not be addressed until "the next time [S&P] change[s] correlation assumptions."

163. The lack of proper correlation criteria infected the rating of asset-backed securities ("ABS") in general, turning it too into guesswork. S&P knew it lacked appropriate correlation rates for ABS so it used a "blanket" approach by applying RMBS correlations to all ABS in a CDO. In November 2004, Stephen McCabe, S&P's lead quantitative analyst on the Cheyne SIV deal, e-mailed his manager that S&P's default rates on ABS transactions were purely guesswork: "from looking at the numbers it is obvious that we have just stuck our preverbal[sic] finger in the air!"

164. In September 2004, fearing a loss of ABS rating market share, Perry Inglis, an S&P managing director in Structured Finance and head of the group that rated the Cheyne SIV, decided to use weaker correlation criteria that were based on ratings of corporate assets – despite knowing that ABS was not diversified enough to support an AAA rating:

> [C]an we perhaps have a chat about this when we get back as we do have new Default Tables and correlation assumptions for corps and it would be good to get an idea of how far these would have to change for us to be "competitive" on these types of deals. I'm a bit unclear if is a big change or a 'wee itty bitty no-one's going to notice' change!

165. In an internal email dated May 23, 2007, an S&P credit analyst suggested that assets in static CDOs (i.e., CDOs whose pools of assets could not change over the life of the CDO) were subject to inadequate stress testing because S&P applied similar default rates to CDO assets without adjusting for riskier assets with more problems. In response, the S&P senior director wrote that "I would recommend we do something. Unless we have too many deals in US where this could hurt" – demonstrating that, while S&P was aware that it did not model correlation risk properly, it would not change its correlation assumptions due to the business impact such changes may have.

166. The flawed correlation assumptions used with S&P's CDO ratings also tainted correlations used for S&P's SIV ratings. S&P was fully aware that the correlation assumptions it used for CDO Evaluator were also applied to its correlation assumptions for SIVs. For example, a June 2005 training package presented to S&P SIV employees explained that SIV "correlation assumptions [are] consistent with those from CDO Evaluator."

167. When it suited S&P's market share goals, S&P even assumed there was "zero" correlation between assets with a common component. For example, two S&P analysts discussed in an April 2007 email that despite knowing a zero correlation assumption would leave a gap in the needed assumptions large enough for a "Mack truck to drive" through, S&P still decided to adopt a correlation of zero between a "CDO of ABS asset and an RMBS asset in a CDO/ABS transaction." One analyst also confirmed that senior S&P CDO management "clearly knew" of this practice and that the head of the CDO group was "responsible." In short, this risky assumption further caused ratings of such correlated assets to be too high.

168. Other criteria like "default tables" were also weakened as necessary to allow inflated ratings. For example, according to July 2004 minutes of a meeting of senior CDO management, senior management knew that more accurate default tables would not be allowed if doing so drove away market share because the "subordinate mezzanine tranches are very sensitive

to ratings and that any slight change to the required credit support to the B- or BB pools would be problematic and could impact our CDO of CDO business."

F. S&P Intentionally Ignored the PIK Stress Test

169. To please issuers, S&P simply ignored another CDO criterion, the payment-in-kind ("PIK") stress test. Some assets underlying a CDO allowed for riskier payment-in-kind tranches. "Payment-in-kind" meant that the manager of the CDO could either pay investors the amount of their regular payment, or add the payment amount to the investors' account. Yet, here too, in 2005, S&P admitted that "we ignore this test [on] so many deals." The test at issue was a PIK stress test for CDOs.

170. At other times, S&P just "winged" it to rate deals. For example, in May 2007, an S&P analyst admitted "[I] am just going to wing it" while struggling to run PIK tests as part of rating two CDO Squared deals. In this case, the analyst was not able to pass the two deals because they kept failing the "PIK stress" test, which was still the "the furthest thing from clear."

171. In short, even though S&P knew it did not have good default table, correlations, or other data for assets like RMBS, CDOs, CMBS or SIVs, it made up such data to rate them anyway. When S&P's former Global Practice Leader for CDOs, Richard Gugliada, was asked, "[i]f you didn't have the data, and you're a data-based credit rating agency, why not walk away" from rating the CDO deals underlying SIVs, he responded: "***The revenue potential was too large***."

G. S&P's Rating Committees Also Relaxed Their Criteria to the Point Where They Would Rate Even a Deal "Structured by Cows"

172. S&P's rating committees also did their part when criteria threatened business-friendly ratings. In April 2004, the co-manager of the CDO group, Dave Tesher, asked if any CDO committee had "forgiven certain cash flows runs that have failed . . . to ultimately arrive at a rating. . . ." Mr. Tesher was told "yes, we do forgive runs all the time in committees."

173. Consistent with "forgiving runs," S&P's rating committees also circumvented the process spelled out in the criteria for the relevant security, and used backroom deals to arrive at inflated ratings and undocumented rating decisions. Rating committee participants knew ratings

were not justified, so preferred not to leave a paper trail. For example, in May 2005, the relevant rating committee for one CDO approved AAA and AA ratings, by a 4-to-3 vote, but the four "yes" votes were not in writing. The committee bypassed "established criteria on the requirements for counterparty ratings" and instead used "a way around the intent of [S&P's] counterparty ratings criteria." An S&P analyst characterized this end-around as:

> a great example of how the criteria process is NOT supposed to work. Being out-voted is one thing (and a good thing, in my view), but being out-voted by mystery voters with no "logic trail" to refer to is another. How can we possibly reconstruct the argument of the winning side for future deals if it does not exist in writing for general reference? Also, it is not clear that this decision will be universally applied. Again, this is exactly the kind of backroom decision-making that leads to inconsistent criteria, confused analysts, and pissed-off clients.

174. In April 2007, two S&P analysts described how bad the criteria had become, acknowledging that they should not be rating a "ridiculous" deal but concluding "it could be structured by cows and we would rate it."

H. S&P Intentionally Ignored Its Own Rating Policy for CDOs of RMBS

175. S&P often rated cash and hybrid CDOs that were still incomplete when rated. The issuers wanted ratings before they had finished assembling the assets for these CDOs, and S&P was happy to oblige. It would rate these unfinished CDOs based on a mix of actual assets in the CDOs and "dummy" assets that were designated by type, rating, maturing date, and size, but had not yet been purchased. From the time of closing, the issuer had a three to six month window to finish purchasing all of the underlying assets, after which S&P promised to update its rating of the CDO and issue a notice containing the final credit rating notice of the CDO. This notice was called "Effective Date Rating Agency Confirmation" ("RAC"). The RAC letter was supposed to confirm the ratings issued at closing, after all the underlying assets of the CDO had been purchased and analysis had been done on those assets to make sure they still deserved the rating originally given. However, S&P often failed to do the necessary analysis to make the representations contained in RAC letters.

176. For example, for CDOs that closed in March 2007 (when S&P still used the LEVELS 5.7 model) any underlying assets replacing dummy assets during the Ramp-up Period in May or after needed to be analyzed under the new LEVELS 6.0 model. If the assets analyzed

under the stricter 6.0 model had to be downgraded, S&P would not have been able to issue a RAC letter. However, S&P failed to use the new version of LEVELS 6.0 on these RMBS, but nonetheless issued RACs for the CDOs.

177. On July 18, 2007, S&P announced that it would "notch" its own ratings on certain underlying non-prime RMBS assets when rating CDOs due to the potential for further downgrades. "Notching" required S&P to drop its rating of the RMBS one level (e.g., from AAA to AAA-) when calculating the rating of the CDO in which the RMBS was contained. The purpose of this policy was to assure the investment community that S&P had factored in the possibility of RMBS downgrades when rating CDOs. However, S&P chose not to apply the notching criteria to all CDO deals. In fact, S&P analysts were told by management not to apply the notching criteria to recently created CDOs that had not yet received a RAC. The analysts were directed to rely on the existing underlying RMBS ratings in writing the RAC – even though S&P knew many of those RMBS were under review for downgrade.

178. Thus, S&P deliberately ignored its publicly announced RAC policy so that it could issue a few more inflated CDO ratings before the bubble finally burst. This also further diminished the value SIVs that were backed by these RMBS or CDO assets.

I. S&P Also Used "Arbitrary" Tricks and "Tweaks" to the CDO Model to Preserve Its Market Share of CMBS

179. While S&P knew in 2005 that there were concerns of a "bubble" in the CMBS, RMBS, and CDO sectors, S&P's top analysts also knew that S&P's modeling of CMBS was defective, and that here too S&P was resorting to "tweaks." PERS invested in SIVs holding CMBS assets.

180. In June 2005, just two months before the issuance of the Cheyne SIV, the senior S&P executive in charge of CMBS knew that S&P was "in desperate need of a more robust default and loss model [to] calculate credit support" for CMBS. Furthermore, "Moody's and Fitch [had] become very competitive and the volume of these deals [had] increased significantly. If we were using Evaluator in its current state without the tweaks, we would not be rating these deals right now. As you know, if we don't rate the CDOs, we will lose the primary deals as

well." In response, S&P's Kai Gilkes expressed concern about the effectiveness of S&P's ratings of CMBS within CDOs to capture market share: "I am keen to understand what the competition is doing for these deals. . . . I agree that CDO Evaluator is not the best solution, and arbitrary tweaks to the assumptions may be dangerous in the long run" because they may lead to inaccurate ratings.

181. An internal 2006 study confirmed again that the default tables of the CDO Evaluator were still not "conducive" for rating CDOs of CMBS. Instead of developing a proper model, S&P used an outdated version of Evaluator for such ratings. Since the outdated Evaluator failed to capture key information about CMBS deals, S&P used "outside-the-model" adjustments, which led to "inconsistencies" of ratings.

182. Despite these concerns, even as late as April 2007 S&P continued to use an inadequate and obsolete CMBS rating model. An S&P presentation listed the problems still plaguing the CMBS rating model. The CMBS model could not adequately support the CMBS ratings business. The model also did not allow for adequate surveillance of CMBS.

183. As with other types of securities, S&P's paramount goal of protecting its turf trumped improving its CMBS rating process. In 2006, S&P's highest managers and executives had coordinated this strategy of weakening the rating model for CMBS – a strategy presented to S&P's President Corbett:

> Fitch and Moody's have recently liberalized their criteria for rating real estate CDOs. Implication: If S&P requires higher credit support levels than the other rating agencies, we will likely lose rating mandates and our dominant market share position. . . .
>
> Members of the CDO group, the CMBS group and SFLT are working on revisions to E3 [Evaluator 3] in an effort to avoid a decline in S&P's market share primary CMBS rating resulting from the rollout of the new evaluator for cash deals. . . .

J. S&P Viewed Its Ratings Models as a "Mousetrap" to Achieve Favorable Ratings and Maintain Market Share

184. In a September 2006 Monthly Activity Report for the CDO group, the head of the CDO group informed Joanne Rose that S&P had already begun working with an outside consultant to develop a "new-generation default matrix" that would give S&P "more flexibility in formulating a business driven default matrix."

185. An April 2007 S&P presentation revealed how far S&P progressed in a model it was now proposing to create a "better mousetrap" to rate asset-backed securities by starting with the desired business friendly ratings, then working backwards. A flowchart illustrated the business focus, showing "[t]he old way was 'a one way street' where S&P would start with data, calculate 'idealized' probabilities of default, then ask 'does this work for our ratings business? If not, the default probabilities would need to be "tweaked.'" The newest "better mousetrap" proposal, or the "two way street," simply started with the desired business outcome. If the data did not lead to the desired business outcome, then S&P simply "use[d] another set" of default probabilities. The "better mousetrap" presentation further explained that:

> [New methodology] . . . We decide on a number of business friendly PD matrices first. Statistical Hypothesis testing allows us to test if our first trial-and-error set is reasonable. If it is not, we can try another or many other matrices.

186. The "better mousetrap" presentation was shared with the directors of S&P's CDO ratings group on May 10, 2007, informing them that the new CDO model approach could be used for any rating or matrix.

187. In August 2007, Mr. Wong updated senior executives of S&P's CDO group on the "better mousetrap" approach, stating:

> I believe it is worth pointing out that while the initial project did focus on Hypothesis Testing to buy us the operational freedom to defend multiple business friendly default matrices, the single first step in coming up with a Hypothetical default matrix to be tested (i.e. where do we begin?) itself is based on Maximum Likelihood Estimation (i.e. Bu couldn't really pull it out of thin air like we did with CDOE3.2) . . . . <u>We then "bend" this transition matrix to suit our business needs</u>. (Emphasis added.)

188. A month later, Mr. Wong confirmed again to the senior executive in charge of the CDO group that the better mousetrap method would "allow us for business reasons to deviate from an ABS default matrix that is estimated from history." S&P stopped this high-level formalization of its existing practices only after the collapse of the CDO markets in later 2007.

K. S&P Failed to Disclose Its "House-of-Cards" Ratings Process for CDO-Related Securities

189. As discussed above, S&P's models for RMBS, CDOs, CMBS and related assets were corrupt. The corruption of S&P's CDO model and rating process was compounded in

S&P's rating of CDO Squared or "CDO2" transactions, where the underlying assets were themselves tranches of CDOs composed of RMBS tranches rated by S&P. The same was true for CDOs that reference RMBS or derivative RMBS tranches rated by S&P. The SIVs that PERS invested in included such assets. Because of the corruption of both the RMBS and CDO models and processes, the ratings for these additional CDO transactions were built on an even weaker foundation of sand.

190. Instead of informing the public about its "scam" or limiting the CDOs it rated, S&P knowingly continued to conduct "business as usual" – maintaining the facade that it issued independent, objective, and reliable CDO ratings. As the Associate Director of S&P's Global CDO Group noted to a senior director at S&P in December 2006:

> [R]ating agencies continue to create and [sic] even bigger monster- the CDO market. Let's hope we are all wealthy and retired by the time this house of cards falters. ;o).

L. S&P Ignored Its Own Warnings About the "Powder Keg" Mortgage Market

191. The Senate Permanent Subcommittee on Investigations also concluded that S&P knew that there were:

> problems in the mortgage market, including an unsustainable rise in housing prices, the high risk nature of the loans being issued, lax lending standards, and rampant mortgage fraud. Instead of using this information to temper their ratings, S&P continued to issue a high volume of investment grade ratings for mortgage backed securities. If S&P had issued ratings that accurately reflected the increasing risk in the RMBS and CDO markets and appropriately adjusted existing ratings in those markets, it could have discouraged investors from purchasing high risk RMBS and CDO securities, and slowed the pace of securitizations.

192. For example, in 2006, S&P personnel knew about the deteriorating performance of RMBS loans but failed to act. Instead, as observed by the head of S&P's Servicer Evaluations for North America, S&P had "become so beholden to their top issuers for revenue they have all developed a kind of Stockholm syndrome which they mistakenly tag as Customer Value creation. . . ." This was in response to an email by an S&P structured finance ratings managing director who described relations with one issuer as "uncomfortably cozy" despite the fact that

"there has been rampant appraisal and underwriting fraud in the industry for quite some time as pressure has mounted to feed the origination machine."

193. In September 2006, the Director of Servicer Evaluations wrote that the head of U.S. RMBS Surveillance told him losses in home loans were in the "high 40s – low 50s %" and that he agreed the cause to be "underwriting fraud; appraisal fraud and the general appetite for new product among originators is resulting in loans being made that shouldn't be made" which "could be a RICO offense!" The Director also wanted to publish a commentary to disclose the high losses he was warned about, but realized this would "too much of a powder keg." Yet, S&P ignored this warning.

194. S&P also learned in September of 2006 that ARM loans – which S&P had failed to model properly in LEVELS – were already "nightmare mortgages." Thus, one S&P personnel emailed that "this is frightening. It wreaks of greed, unregulated brokers, and 'not so prudent lenders' . . . . Hope our friends with large portfolios of these mortgages [were] preparing for the inevitable." Again, S&P ignored this warning.

195. A month later, in October 2006, S&P managing director confirmed that news of deteriorating home loans was "[p]retty grim as we suspected . . . I think things are going to get mighty ugly next year!" S&P ignored this warning.

196. Not until March of 2007, when many of the deals rated by S&P were collapsing, did S&P stop ignoring its own warnings. An RMBS Group presentation to President Terry McGraw of McGraw-Hill Companies and his "executive committee" discussed the subprime "brou haha reaching serious levels . . . and how we rated the deals and are preparing to deal with fallout (downgrades)."

197. In February 2007, S&P director Frank Parisi informed senior management that losses for 2006 vintage subprime RMBS deals could be one and half to two times as high as losses for 2000 vintage deals. Dr. Parisi had studied the different vintages because the head of U.S. RMBS surveillance had expressed concerns about deteriorating RMBS conditions in 2006.

198. In March 2007, the President of S&P was also informed that the subprime "2006 vintage being only 50% more risky than 2000 vintage ma[y] understate the risk." Notebook

entries of data prepared for S&P EVP Vickie Tillman a day later state that more than half of BB+ and BB were "expected to take some loss" – an exceptionally high loss rate.

199. Also in March 2007, an instant message exchange between two S&P analysts captured the "gist" of senior management warnings that the "market will crash." Yet as last-minute deals rushed in, analysts were told to "be cooperative" and not "push criteria" that got in the way of closing deals before the crash.

200. Again, in April 2007, an S&P analyst warned that default numbers for BBB and BBB- 2005 and 2006 subprime RMBS were substantially higher than previously predicted. S&P continued to disregard warnings that would interfere with rating as many RMBS as possible to capture maximum revenues.

201. When S&P finally took action, a director of the Servicer Evaluations team, responded that S&P "[s]hould have been doing this all along." However, S&P did too little, too late.

M. S&P Also "Grandfathered" RMBS and CDO Deals Using Different "Tricks" to Avoid Losing Market Share

1. S&P refused to apply more accurate rating models or information to re-rate already rated RMBS

202. Despite the warnings of deteriorating loan market conditions, the senior manager overseeing S&P's RMBS surveillance group simply refused to apply updated models to existing ratings on deals – a practice referred to as "grandfathering" – and was pressured by upper management not to re-rate these deals using the updated model. The reason S&P did so was simple: it did not want to upset the issuers of the grandfathered securities. If S&P had done otherwise, many securities would have been put on Credit Watch or been downgraded as early as 2005, causing major headaches for their issuers.

203. S&P was also motivated to continue grandfathering to match Moody's. S&P knew that Moody's was grandfathering its previous ratings on deals even though Moody's publicly said it was not doing so. In March 2006, the head of European Structured Finance at S&P, Ian Bell, met with his counterpart at Moody's and then emailed top executives at S&P about what Moody's revealed to him:

> FYI. Just sat on a panel with Frdric Drevon, my opposite number at Moody's who fielded a question on what happens to old transactions when there is a change to rating methodologie [sic]. The official Moody's line is that there is no "grandfathering" and that old transactions are reviewed using the new criteria. However, "the truth is that we do not have the resources to review thousands of transactions, so we focus on those that we feel are more at risk." Interestingly, Olivier Dufour from Fitch said they "grandfathered" as it would otherwise be "unfair."

204. In May 2006, S&P represented to its Structured Finance Investor Council that "S&P Structured Finance does not refer to the term 'grandfathering' when discussing the impact that implementation of new criteria may have on existing ratings." Despite this representation, a June 23, 2006 email chain about a minor revision to the LEVELS model reveals how S&P's top RMBS Client Value Manager and other senior executives rationalized their decision to secretly "grandfather" existing ratings while claiming to do the exact opposite:

> Simply put – although the RMBS Group does not "grandfather" existing deals, there is not an absolute and direct link between changes to our new ratings models and subsequent rating actions taken by the RMBS Surveillance Group. As a result, there will not be wholesale rating actions taken in July or shortly thereafter on outstanding RMBS transactions, absent a deterioration in performance and projected credit support on any individual transaction.

2. S&P also grandfathered CDO securities

205. A June 2005 email showed that grandfathering was the "overarching" reason S&P delayed releasing updates to its CDO Evaluator model (ultimately CDO Evaluator 3.0), since using the updated model on all the deals could significantly disrupt its business.

206. In July of 2005, S&P was desperate to find a "trick" to avoid using its updated E3 model to re-rate previously rated CDO deals. In keeping with S&P's foremost strategic goal of protecting its turf, rather than accurate ratings, an S&P CDO analyst, who was also a Client Value Manager, explained that "[t]he trick is of course to minimize impact on deals."

207. S&P came up with just such a trick a few months later. Instead of properly analyzing the relevant underlying data of a deal, S&P would test out certain "tolerances" to achieve the desired business-friendly result. In November 2005, S&P proposed and eventually used a mix of "tolerances" with a new rating model combination called E3/Low and E3/High. E3/Low was a more permissive rating alternative model that would allow AAA ratings on more

deals. S&P's goal was not to re-rate deals accurately but to ensure that S&P's high market share was not disrupted when a prior deal had to be re-rated. S&P would also minimize disclosing the results of these tricks to issuers.

208. Of course, if investors knew that S&P was deliberately rating deals using obsolete models to keep issuers happy, they might cease to rely on those ratings. So S&P did not fully disclose what it was doing, and created confusion even when it disclosed some if its grandfathering practices – in direct contradiction to its promise to conduct ratings and surveillance in a "transparent and credible" manner.

209. For example, in December 2005, S&P senior executives were reminded that S&P's confusing grandfathering practices surrounding the release of CDO Evaluator 3.0 still required creating "a policy framework" that would disclose clearly when S&P would grandfather new transactions. Without that policy framework, S&P was "not being as transparent as we need to be" in the market. The senior executives had been warned of the need to create this framework months before, but had failed to implement it. Later, in early 2006, S&P's CDO leader, David Tesher, confirmed that the "tolerance bands still "created confusion given their lack of transpar[e]ncy."

N. S&P Starved Key Rating and Monitoring Groups of Staff and Needed Resources as an Excuse to Avoid Losing Business

210. S&P's post-rating practices were no better than its rating practices for new securities. Just as S&P had weakened the rating process to increase its profits and market share, it also corrupted the surveillance of those ratings.

211. S&P's representations that it would use relevant, reliable, and up-to-date analytics in monitoring its credit ratings were false. S&P failed to maintain robust surveillance practices that would, as represented, ensure that ratings continued to reflect their credit assessment.

212. S&P's Surveillance Group "only re-review[ed] a deal under new assumptions/criteria when the deal is flagged for some performance reason." In other words, regardless of how risky S&P suspected a security might be, the security would not be re-rated so long as it continued to perform (such as make payments on time). An S&P managing director of

surveillance explained that "[t]he two major reasons why we have taken the approach is (i) lack of sufficient personnel resources and (ii) not having the same models/information available for surveillance to relook at an existing deal with the new assumptions (i.e. no cash flow models for a number of assets). The third reason was concerns over how disruptive wholesale rating changes, based on a criteria changes, can be to the market."

213. Even when Surveillance tried to update some of the deals, it was thwarted by management's desire to maintain its market share. In late 2006, Ernestine Warner, the head of RMBS Surveillance, complained to a senior executive on a weekly basis of not being able to downgrade the subprime RMBS as necessary. Her complaint was that Tom Gillis, the Chief Quality Officer, ignored her requests because of business reasons.

214. But instead of quickly adapting to dramatically changed circumstances, an ongoing and "often heated" discussion resulted when Mr. Raiter, former head of RMBS, tried to persuade the surveillance group to use updated models. The Surveillance Group would not use the updated models.

215. It was only after numerous deals started to default that S&P was forced to take action. By the end of April 2007, the Surveillance Group finally began moving away from using outdated models. For instance, on 2005 vintage securities, the Surveillance Group began to apply newer methods that identified deals at risk of downgrade before significant realized losses.

216. Had S&P fulfilled its promise to "updat[e] on a timely basis the rating, as appropriate" beginning in 2004, Mr. Raiter, testified that "we might not have had to wait until 2007 for the poor performers to come to light. Again, had the best practices been in place, some of the worse performing products might have been extinguished before they grew to such a size that they disrupted financial markets." However, due to (a) concerns about ratings volatility and potential loss in revenue, and (b) the fact that S&P failed to give proper attention to the long-standing problem of inadequate resources in the Surveillance Group, the new modeling to review the performance of outstanding ratings was not timely implemented by management of the Surveillance Group.

217. As of June 2005, the SFLT knew from S&P's 2006 Strategic Plan that its RMBS, CDO and CMBS groups were "not currently staffed or resourced to meet the demands." The 2006 Strategic Plan also warned SFLT that a "bubble" was developing in the CMBS, RMBS and CDO sectors, and a bubble burst would cause a "large number of rating downgrades" and "high negative rating volatility."

218. The SFLT also knew from S&P's 2006 Strategic Plan that "the effect of reduced timeliness of [RMBS] surveillance as a result of resource demands for new ratings, will increase notching for rating changes, impact the integrity of our transition studies and market perception." Still nothing was done to meet the surveillance resource needs.

219. The CDO Ratings Group also knew it too was severely understaffed. In December 2005, for example, efforts to address staffing needs in the CDO area were inadequate. S&P's CDO Ratings Group was still looking for ways "to achieve a state where the departure of 1 or 2 quants [quantitative analyses] (especially junior quants) does not impact our business severely as is the case today."

220. In October 2006, the head of S&P's CDO Ratings Group warned the head of the Structured Finance Division about the harm from insufficient staffing. She wrote about the revenues and numbers being the priority over service: "While I realize that our revenues and client service numbers don't indicate any ill [e]ffects from our severe understaffing situation, I am more concerned than ever that we are on a downward spiral of morale, analytical leadership/ quality and client service." This warning followed another a month before – in a report between the same two senior executives – about future calamities looming ahead: "the cooling of the housing market is inevitable and the deterioration of the RMBS market and the financial health of mortgage lenders and builders remain on every market participant's mind."

221. In late 2006, the RMBS Surveillance unit was in clear need of staffing help, and management knew it but did nothing. The Surveillance unit needed more staff to rate 863 deals, in addition to the "back log of deals that are out of date with regard to ratings." This urgent request for staffing was not addressed by S&P and therefore the "big backlog of work for RMBS surveillance" was still apparent in 2007.

222. While these events were happening, S&P represented to its Structured Finance Investor Council in November 2006, that "S&P has an integrated surveillance process to ensure that RMBS assets in CDOs of ABS are appropriately monitored and reflect Standard & Poor's most current credit view.

223. By January 2007, at an RMBS Surveillance team meeting headed by Ernestine Warner (the senior director of U.S. RMBS Surveillance), the team observed that a housing bubble existed, with a default projection of 20 percent. The team observed that for deals rated A and below, 80 percent of them were in "trouble." Given this environment, the Surveillance team's plan for handling credit watch issues was to identify all the worst pools of 2006 (after setting a cutoff point for delinquencies at 20-30 percent) and place them all on Credit Watch with negative implications.

III. Reasons False as to SIVs

224. With respect to SIVs, there were two basic areas where S&P's ratings proved false: (1) the ratings of the SIVs and their securities, and (2) the ratings of the assets the SIVs purchased. As described below, S&P failed to comply with its publicly announced standards in both of these areas.

A. S&P Inflated the Ratings of the SIVs and the Securities They Issued

1. S&P failed to rate the SIVs independently and objectively as required by its public rating methodology and criteria

225. S&P stated, "To be confident that the [SIV's] senior liabilities are able to maintain the highest possible ratings until maturity, Standard & Poor's measures capital adequacy on the basis that the vehicle enters into immediate wind-down, sometimes referred to as 'defeasance' or 'enforcement.' The question that arises therefore is this: if the SIV enters into defeasance or enforcement today, can it sell its assets and repay its liabilities such that the level of capital in the vehicle at the time of the defeasance is sufficient to maintain the 'AAA/A-1+' rating on those liabilities until they are repaid in full or have matured...?" S&P represented that under the scenarios tested, the senior liabilities would be repaid in full by the SIVs. Those representations were false.

226. In reality, S&P gave the SIVs and their securities ratings that it knew they did not deserve. S&P's SIV rating model did not operate as represented. Instead, S&P assumed that the SIV would face unrealistically low fire-sale discounts in these circumstances. S&P also failed to account for the possibility that other SIVs would also be selling off their assets at the same time, potentially flooding the market and further depressing prices. Rather, S&P assumed the SIV would be able to sell its assets for nearly 100% of their fair market value.

227. When the SIVs did in fact enter run-off, they were often lucky to get 50% of the market value of their assets, creating massive losses for PERS and other investors.

228. Furthermore, critical data that S&P used to rate the SIVs was either nonexistent or unreliable, and S&P knew it. For example, in 2004, an S&P analyst responsible for rating the Cheyne SIV (one of the SIVs at issue in this case) stated, "As you know, I had difficulties explaining 'HOW' we got to those numbers since there is no science behind it . . . and eventually I told him that we had to adjust in order to make committee comfortable with the peer comparison."

229. S&P also made ad hoc adjustments based on pressure from its client issuers. For example, S&P was pressured to adjust its capital buffer on the Cheyne SIV's capital notes. In 2004, an S&P rating analyst for the Cheyne SIV articulated that S&P "[has] always been very cautious in making sure that the rating of the capital notes is extremely stable," especially because of "the impact that a minimum downgrade on the capital notes could have on the senior notes in terms of market perception." S&P initially advised that a 1% capital buffer was needed underneath the Cheyne SIV's mezzanine capital notes ("MCNs") to rate the capital notes up to BBB+. Although S&P stated that the 1% capital buffer was a "pillar of [its] analysis," S&P ultimately acquiesced to pressure from Morgan Stanley – the architect of the Cheyne SIV – and allowed Cheyne to reduce the buffer by 25%. In another example, when S&P's Lapo Guadagnuolo initially informed Morgan Stanley that the targeted A rating on the Cheyne MCNs was not possible and that S&P was willing to assign only a BBB to the Cheyne MCNs, a threatening email to S&P's Perry Inglis made "it clear that [Morgan Stanley] believe[s] the position committee is taking is very inappropriate." Again, S&P acquiesced to pressure from

Morgan Stanley and agreed to assign an A rating to the Cheyne MCNs (despite the lower capital buffer).

230. The Cheyne MCNs' A rating was also helped by S&P relaxing its criteria. S&P's rating analyst on the Cheyne SIV decided that "the step we needed to undertake in order to rate the capital notes was to assume a probability of enforcement of less than 100%. This 'relaxation' of our methodology would apply ONLY for capital notes seeking a rating up to 'A.'"

2. S&P succumbed to issuer pressure when it ignored the lack of experience of the Cheyne SIV Manager

231. S&P broke its own rules on behalf of its client issuers when it ignored the Cheyne SIV managers' inexperience. S&P had always insisted that the SIV manager was a key element in S&P's rating analysis. SIV managerial experience was important because SIVs – including Cheyne – were especially complex, in part because the SIVs held many changing different asset types over time. As one S&P manager put it, ". . . we will have to explain to the market that first time managers <u>cannot</u> achieve top ratings by S&P, regardless what the structure allows/does not allow them to do." (Emphasis added)

232. In mid-2004, Morgan Stanley, which happened to be one of S&P's biggest customers, requested an A rating from S&P for a key component of the Cheyne SIV. S&P advised Morgan Stanley that Cheyne's lack of managerial experience was one of the reasons that an A rating could not be given. However, after Morgan Stanley repeatedly pressured S&P, S&P amended its feedback and dropped its requirement of an experienced SIV manager.

233. In May of 2005, S&P again acquiesced to Cheyne's demands for an exception to the rules in spite of Cheyne's lack of track record as manager. Cheyne requested the same treatment as another SIV, Sedna, regarding breach of certain liquidity tests. When a SIV breached certain tests that measured the minimum amount of liquidity to be provided and did not cure the breach for more than 5 business days, an enforcement or defeasance action was initiated. Sedna was allowed to breach any of these tests once every year and not face defeasance/enforcement, provided it cured the breach within 10 business days. Cheyne wanted

the same treatment as Sedna even though Sedna's managers had more experience. Yet S&P yielded even though Cheyne was a new manager without a track record.

3. The SIVs collapsed because of risks S&P should have foreseen

234. By late 2007, the market for SIV notes evaporated. As the same time, asset prices fell and the SIVs began to go into defeasance as a result. As they went through defeasance and sold off their assets, the truth about the quality of those assets began to be revealed. Because of the low quality of the assets in the SIVs' portfolios (despite AAA ratings from S&P), the SIVs had to sell assets at substantial discounts. Exacerbating this problem, multiple SIVs were selling their assets at the same time, driving the market prices for them still lower. And because these sales were involuntary, the SIVs were forced to take additional "fire sale" discounts. All of these developments were foreseeable, but S&P either unreasonably minimized their impact in its model or failed to account for them entirely.

235. The collapse of many of the SIVs happened in a matter of weeks. S&P did not downgrade the ratings on the SIVs, let alone put the SIVs on negative watch, until shortly before the SIV structures collapsed into dissolution. Holders of senior SIV securities, including PERS, sustained major losses.

B. S&P Inflated the Ratings of the Securities Held by the SIVs

236. Compounding the problems in the ratings of the SIVs themselves and the securities they issued, S&P knowingly corrupted the ratings of the securities in which the SIVs invested. Those securities provided the funds that the SIVs used to pay investors such as PERS, so flaws in those ratings directly affected the riskiness of PERS's investments in SIV securities. Those fraudulent ratings also proximately caused PERS's losses on SIV securities because the SIVs took massive losses when they were forced to sell their assets, and they passed those losses along to PERS and other investors.

1. Defects in the RMBS held by SIVs

237. The defects in S&P's RMBS ratings are discussed in detail above. Those defects infected most or all of the S&P-rated RMBS held by the SIVs in which PERS invested.

2. Defects in the CDOs and other assets held by SIVs

238. As noted above, CDOs, CMBS, and ABS were also significant components of the SIVs' portfolios. S&P's failure to accurately rate these assets was a key reason why the SIVs ultimately collapsed, and a direct cause of PERS's and other investors' losses when that collapse occurred.

C. S&P Played a Much Larger Role in SIVs Than It Claimed

239. As set forth above, S&P was deeply involved in structuring SIVs, and advised them regarding their assets, capital structure, and other matters. This was inconsistent with S&P's public claim that it "does not act as an investment, financial, or other advisor to, and does not have a fiduciary relationship with, an issuer or any other person. [S&P] does not become involved with the actual structuring of any security it rates, and limits its comments to the potential impact that any structuring proposed by the issuer may have on the rating."

DEFENDANTS' MISREPRESENTATIONS ABOUT SPECIFIC SECURITIES PURCHASED BY PERS AND STRS

240. S&P's misconduct in rating securities did more than render false its representations about its integrity, independence, expertise, and that it avoided influence by market share and revenue considerations. That misconduct also infected each of the ratings S&P issued to the securities purchased by PERS and STRS. S&P had no reason to believe that those ratings matched S&P's public standards. Indeed, S&P had ample reason to believe the opposite. And S&P did not in fact believe the ratings of the securities listed in Appendix A to be accurate. Indeed, the S&P personnel actually creating these ratings – and their senior managers – knew of, condoned and often referred internally to the corruption of its rating methods with euphemisms like "massage," "tweaking," "adjusting," "relaxation," "tolerance band," "wing[ing]," "bend," "cushion," "random," "arbitrary," and "give and take." Other times, S&P described the corruption in more vivid terms like "magic numbers," "f**ing scam," "structured by cows," "house of cards," "ridiculous," "finger in the air," and "pull it out of thin air."

241. All of the RMBS listed in Appendix A were rated using the versions of LEVELS in existence between 2004 and 2007. As described above, S&P knew these versions of LEVELS

were based on obsolete data and employed "guesses" and "magic numbers." Further, the RMBS ratings were "massage[d]" to please issuers and compete with Moody's. In fact, LEVELS was so bad that S&P recognized that its results were little better than a "coin toss." Further, a number of the RMBS listed on Appendix A were backed by HELs, HELOCs, Alt-A mortgages, ARMs, and other loans for which S&P knew LEVELS was particularly inaccurate.

242. As a result of these and other flaws, S&P could not possibly have thought that, for example, an AAA rating generated by LEVELS actually meant that an RMBS had an "extremely strong capacity to meet financial commitments," an AA rating meant an RMBS had a "very strong capacity to meet financial commitments," and so on. S&P self-evidently did not believe that these ratings met its published standards.

243. S&P's internal evaluation of the accuracy of its RMBS ratings was charitable in comparison to its views on its ratings of CDOs that went into the SIVs whose securities PERS purchased. Those ratings were a "f**king scam." The CDO rating process was "a house of cards" built on "random criteria." The ratings process was corrupted by business considerations to the point where senior executives admitted that, "it was wrong and I knew it at the time."

244. S&P's SIV ratings were compromised not only by the problems with the RMBS and CDOs the SIVs contained, but also by independent and glaring problems with the SIV rating models themselves, such as the failure to make any realistic effort to model the actual performance of a SIV during defeasance.

245. All of the ratings listed in Appendix A were therefore false and fraudulent. They did not represent S&P's true analyses of the creditworthiness of the rated securities. Rather, S&P issued them with, at best, reckless disregard and deliberate ignorance as to whether the securities merited the ratings given to them. More likely, S&P knew that the securities did not meet the standards for their ratings, but intentionally gave inflated ratings to maximize its revenue and market share.

PERS AND STRS LOST HUNDREDS OF MILLIONS OF DOLLARS ON STRUCTURED FINANCE SECURITIES GIVEN FRAUDULENT RATINGS BY S&P

246. As described herein, S&P's ratings of structured finance securities were deeply flawed, and S&P knew it.

247. By the second half of 2007, the problems with these securities became too obvious for S&P to ignore. On July 11, 2007 S&P publicly announced that it was placing many non-AAA-rated 2005 and 2006 vintage subprime RMBS on CreditWatch and that large-scale downgrades of these assets would follow. At the same time, S&P announced that it was bolstering its requirements for subprime RMBS rating and surveillance. S&P further announced that it was improving its LEVELS model, and requiring stricter credit protection for deals closing on or after July 10, 2007, among a number of changes to "better mitigate" concerns about its rating methodology going forward.

248. Only one day later, on July 12, 2007, S&P announced a mass downgrade of non-AAA-rated 2005 and 2006 vintage subprime RMBS.

249. In fact, S&P knew that the problems with its ratings were much more widespread. In a July 8, 2007 email, for example, the head of S&P's U.S. RMBS surveillance group stated that "everything that was rated since the 4th quarter of 2005" was suspect. This email responded to another S&P surveillance employee who expressed his surprise that the new issue and criteria group agreed with the ongoing drastic rating changes, then stated that "Alt-A and Prime are next." Further, the head of U.S. RMBS surveillance said that "[d]eals that closed last week (June 30) will also be on cw [Credit Watch]." Investors, such as PERS and STRS, were left in the dark about these broader problems, of course.

250. On October 17, 2007, S&P downgraded 1,713 subprime, Alt-A and closed-end second RMBS rated between January 1, 2007 and June 30, 2007. S&P downgraded the 2007 RMBS because "the same risks that are apparent in the transactions issued in 2006 [were] also present in the 2007 transactions." S&P did not reveal that it had long known that the problems were not limited to 2005 and 2006 subprime RMBS. For example, it continued to hide the facts

that its models and criteria for rating non-subprime RMBS (including Alt-A, HELOC, HEL, and Prime) were defective.

251. Key S&P managers and analysts who had participated in the decisions to prevent the use of adequate RMBS models and criteria from 2004 and after were among the S&P managers and analysts named on the public announcements of these downgrades, including Barnes, and Gillis. As a result, even during the period of downgrades between July and October 2007, by concealing the extent of the RMBS rating problems, and delaying rating downgrades, S&P misled investors into a false sense of security.

252. In the ensuing market collapse, PERS and STRS lost hundreds of millions of dollars on RMBS and SIVs that had been rated AAA by S&P.

S&P'S MISCONDUCT CONTINUES

253. On February 7, 2008, S&P publicly announced that it would take "leadership actions" to further strengthen the rating process and help restore confidence in the markets following the financial crisis. At the time of the announcement, S&P President Deven Sharma represented:

> The ongoing transformation of the financial markets requires us to continue to bring more innovative thinking, greater resources, and improved analytics to the rating process…By further enhancing independence, strengthening the ratings process, and increasing transparency, the actions we are taking will serve the public interest by building greater confidence in ratings and supporting the efficient operation of the global credit markets.

254. S&P's "leadership actions" included separating S&P's criteria development groups from its commercial groups so they would be independent and not influenced by business concerns, and strengthening criteria on most of the major asset classes.

255. On May 8, 2008, S&P hired Mark Adelson – a former vocal critic of rating agencies – as its Chief Credit Officer to manage the new independent criteria group and supervise key changes to S&P's rating criteria and methodologies.

256. In August 2008, S&P hired David Jacob to manage S&P's Structured Finance group, on the commercial rating side of the business, as part of S&P's efforts "to improve transparency, build investor confidence, and continue to deliver high-quality, independent

analytics." Jacob wanted to "ensure that S&P analysts didn't loosen standards at the request of bankers." Jacob, like Adelson, had been a critic of rating agency conduct. Prior to joining S&P, Jacob and Adelson had been partners in a consulting firm.

257. In October 2008, S&P President Deven Sharma reaffirmed S&P's promises of reform to the House Committee on Oversight and Government Reform, testifying that S&P had taken a number of actions to enhance its rating process and restore the market's confidence in its ratings following the financial crisis.

258. In keeping with his philosophy that rating criteria should be as reliable "as jet engines on an airplane," Adelson helped revise S&P's rating methodology for CMBS to a more conservative model that established an "AAA credit enhancement level that would be sufficient to enable tranches rated at that level to withstand market conditions commensurate with an extreme economic downturn without defaulting." With the release of the new criteria on June 26, 2009, the ratings on 1,586 tranches of CMBS transactions were immediately placed on Credit Watch negative, indicating that the rating may be lowered. After the revised methodology went into effect, S&P lost CMBS business to its competitors, Moody's and Fitch.

259. In September 2009, S&P President Sharma again reaffirmed S&P's promises of reform in testimony before the House Financial Services Subcommittee, whom he assured that S&P had learned from the past regarding its ratings on structured finance securities, and that it had made "major changes" to restore confidence in its ratings. Sharma cited S&P's separation of its criteria development groups from its commercial groups and other actions taken to avoid conflicts of interest.

260. In December 2010, under Adelson's leadership, S&P published an update that toughened its methodologies and assumptions for counterparty criteria. Counterparty risk is an important factor in determining the credit risk of structured finance securities. The updated criteria were criticized by market participants who contended that they were too onerous.

261. Despite the reform efforts by Adelson and Jacob, the emphasis on market share at the expense of analytics began growing again at S&P. In the spring of 2011, S&P President Sharma called Jacob and "gave him hell" about loss in business. Jacob explained that the loss

was due in part to securities which required counterparty criteria that Adelson had toughened. Sharma pressured Jacob to do something about it, but Jacob said he was not able to do so because of the separation between the business and analytical sides at S&P. Sharma was unhappy with Jacob's response. Following the conversation, Sharma sent an email to Jacob and Paul Coughlin, S&P's global head of corporates and governments, stating that they needed to consider "changing direction."

262. In June 2011, S&P ratcheted up the pressure on Adelson and Jacob. It brought them to an S&P leadership meeting organized by Sharma based on the theme: "Relentlessly Driving Global Growth." Contrary to S&P's public claims that it was "further enhancing [its] independence," S&P executives were explicitly urged to let issuers influence them. For example, speakers and meeting materials emphasized that, "Structured finance criteria can easily be irrelevant if market feedback [is] ignored."

263. Meeting materials described S&P's strategy as follows: "Success in criteria development depends on ongoing collaboration between the criteria group and the business." Further, "Efforts are underway to improve the current processes and interactions in the development and dissemination of new criteria. This includes . . . integrating marketplace/investor viewpoints into the criteria process."

264. However, Adelson and Jacob still failed to "collaborate" with issuers or "change direction" to S&P's satisfaction. In mid-2011 a report by S&P's Structured Finance Department emphasized that since January 2011, S&P was not asked to rate 13 deals due in part to its counterparty criteria, and that as a result, S&P lost approximately $2.275 million in potential revenue.

265. In December 2011, S&P announced Jacob's departure from the company, and Adelson's removal from his position as Chief Credit Officer.

266. In May 2012, S&P's counterparty criteria were made generally more lenient.

267. Despite representations by S&P to the contrary, once S&P began to lose market share to its competitors as a result of toughening its criteria, the promised reforms were rolled back. S&P executives began to pressure staff to adjust methodologies and assumptions used to

rate structured finance securities so that S&P could more easily assign its highest rating and increase its market share and revenue.

ACTUAL MALICE

268. The law does not require the People to establish that S&P acted with actual malice, as S&P's false statements as described herein do not enjoy any privileged status under the United States or California constitutions for multiple reasons. First, S&P's false statements were commercial speech. Further, S&P's false statements were not statements about any public figures or matters of public concern within the meaning of the First Amendment. Even if the People were required to establish actual malice, however, the facts alleged herein show that S&P did in fact act with actual malice. As shown above, S&P made the false statements alleged herein with knowledge that they were false or with reckless disregard for whether or not they were true. S&P did not believe the statements were true, entertained serious doubts as to their truth, or purposefully avoided the truth regarding their subjects.

269. As alleged herein, S&P's false statements were made for the purpose of promoting, marketing and selling its rating product, and for the purpose of structuring, pricing, marketing, and promoting the rated securities.

270. S&P's ratings were the result of an iterative, consultative process in which the issuer would describe the ratings it sought and S&P would advise the issuer about what would be required for S&P to give the security the rating desired by the issuer and provide additional, related analytic and consultative services.

271. All of S&P's ratings were the product of the "issuer pays" model described above, under which S&P was paid by the issuer to develop and provide its ratings. S&P would not be paid, or at least would not be paid its full scheduled fee, unless it delivered the ratings desired by the issuer. S&P had a close relationship with most if not all of the entities involved in issuing the securities at issue, most or all of whom were repeat customers. As found by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act, S&P's activities as described herein "are fundamentally commercial in character." (See PL 111-203, 124 Stat 1376, § 931, subd. (3).)

272. Neither the SIVs nor the trusts or other special purpose entities that issued the RMBS purchased by PERS and STRS were publicly-owned or publicly-traded companies.

273. The ratings at issue in this action were directed to a select group of investors. SIV notes could only be sold, and were necessarily only marketed to, investors who qualified under the federal securities laws as "Qualified Institutional Buyers" and "Qualified Purchasers," and not to the general investing public. Similarly, RMBS were not marketed or sold to the general public. Rather, they were marketed and sold to a very select group of investors who could afford to purchase securities priced in the tens or hundreds of millions of dollars – generally large institutional investors. Other structured securities at issue in this action, such as CDOs, were marketed and sold to only a similarly select group of investors. Though some or all of the ratings at issue might have been accessible to members of the general investing public who sought them out, the ratings were targeted and sent only to the select groups of investors described, and for the purpose of inducing them to buy the rated securities.

STATUTES OF LIMITATIONS

274. The People entered into an agreement with S&P tolling the statute of limitations applicable to the People's claims stated herein as of June 15, 2011. The pertinent statutes of limitations are as follows: four years for the Unfair Competition Law claims; three years from the Attorney General's discovery for the False Claims Act claims; and three years from the aggrieved party's or Attorney General's discovery for the False Advertising Law claims.

275. To the extent any of the People's causes of action would otherwise have accrued, or an applicable limitations period(s) have begun to run, before the dates that were three or four years before the tolling agreement effective June 15, 2011 – i.e., before June 15, 2008 or June 15, 2007 – and the People do not concede that any such predicate occurred – the People invoke the common law discovery rule and any other common law doctrines that may apply, including the doctrines of fraudulent concealment and continuous accrual, and in support thereof allege the following.

276. The People did not discover S&P's false, fraudulent, or misleading representations, practices, or advertising (collectively, "fraud") until after June 15, 2008. Neither

the People nor the Attorney General knew of S&P's fraud, or knew of facts that would lead a reasonably prudent person to suspect it, until after June 15, 2008. Prior to June 15, 2008, neither the People nor the Attorney General had any reasonable means of knowledge or notice which, followed by an inquiry, would have revealed S&P's fraud by the dates on which the applicable statutes of limitations might otherwise have begun to run. In particular, the People did not have knowledge or possession of internal S&P communications that reveal S&P's fraud until well after June 15, 2008.

277. Prior to June 15, 2008, S&P gave repeated, specific, public assurances – including in two appearances before Congress – that its ratings and ratings processes were objective, independent, and free from undue influence, and that its rating "opinions" had been genuinely held. These and other words of comfort from S&P gave false assurance that there was no fraud to be discovered.

278. In addition to the statements by S&P described above regarding the objectivity, independence, and integrity of its ratings, on April 17, 2007, Susan Barnes, Managing Director for S&P Ratings Services, testified before the United States Senate Committee on Banking, Housing, & Urban Affairs, Subcommittee on Securities, Insurance, and Investment, that "S&P has established an excellent track record of providing the market with independent, objective and rigorous analytical information and credit rating opinions," that "S&P conducts its business grounded in the cornerstone principles of independence, transparency, credibility and quality," and that "[t]hese principles have driven our [S&P's] long-standing track record of analytical excellence and objective commentary."

279. Similarly, in a letter to the editor published in the Wall Street Journal on September 17, 2007, Vickie Tillman, Executive Vice President for S&P's Credit Market Services, stated of structured finance transactions that "we rate these deals based on our criteria – criteria that are publicly available, non-negotiable and consistently applied," that "[o]ur [S&P's] credit ratings provide objective, impartial opinions on the credit quality of bonds," that "[w]e have institutional safeguards in place to ensure the independence and integrity of these opinions," and that while questions had been raised in an article published that month "about the about the

independence and integrity of our ratings, citing the potential conflict of interest arising from our business model[,] [w]e have numerous safeguards in place that have helped us effectively manage such conflicts."

280. Also, on September 26, 2007, Ms. Tillman testified before the United States Senate Committee on Banking, Housing, & Urban Affairs that "some have questioned whether the 'issuer pays' model has led S&P and other to issue higher, or less rigorously analyzed, ratings so as to garner more business. First and foremost, there is no evidence – none at all – to support this contention with respect to S&P;" that "S&P maintains rigorous policies and procedures designed to ensure the integrity of our analytical processes;" and that "we do not compromise our criteria to meet a particular issuer's goals;" and that S&P had specific policies, some of which Ms. Tillman described, to ensure the integrity of its rating process and manage potential conflicts from the issuer-pays model. Also, contrary to what is now known about S&P's failure to update its LEVELS model for calculating the default probabilities for loans backing RMBS when it knew it should have, Ms. Tillman gave the specific words of comfort that, "[t]he assumptions and analysis embedded in the LEVELS® model are under regular review and are updated as appropriate to reflect our current thinking abut residential mortgages."

FIRST CAUSE OF ACTION
False Claims Act - Government Code § 12651, subd. (a)(I)
(Against All Defendants)

281. The People incorporate herein by reference the allegations in paragraphs 1 through 280 of this complaint.

282. This is a claim for treble damages, penalties, and costs brought by the People under the California False Claims Act ("CFCA"), Government Code Sections 12650-12656.

283. The terms "knowing" and "knowingly" have the meanings assigned to them in the CFCA.

284. Defendants knowingly caused to be presented to PERS and STRS false or fraudulent claims for payment or approval for securities including but not limited to the securities identified in Appendix A to this Complaint. Defendants' conduct was a substantial factor in causing the false claims to be presented. Defendants provided their knowing misrepresentations

for the purpose of having them included in the securities' offering materials and offers for sale, which Defendants intended and knew or should have known would be offered for sale to PERS and STRS.

285. Defendants' misrepresentations had a natural tendency to influence, or were capable of influencing, PERS's and STRS's decisions to purchase the securities at issue in this action, and to purchase them on the terms offered, including but not limited to the securities identified in Appendix A.

286. As a proximate result of Defendants' actions, the People suffered damages in a specific amount to be determined at trial.

SECOND CAUSE OF ACTION
False Claims Act - Government Code § 12651, subd. (a)(2)
(Against All Defendants)

287. The People incorporate herein by reference the allegations in paragraphs 1 through 286 of this complaint.

288. This is a claim for treble damages, penalties, and costs brought by the People under the California False Claims Act, Government Code Sections 12650-12656 et seq.

289. By the same acts described in the People's First Cause of Action, Defendants knowingly made, used, or caused to be made or used false records or statements to get false claims paid or approved by PERS and STRS, and knowingly made, used, or caused to be made or used, false records or statements material to false or fraudulent claims.

290. Defendants' misrepresentations, records, or statements had a natural tendency to influence, or were capable of influencing, PERS's and STRS's decisions to purchase the securities at issue in this action, and to purchase them on the terms offered, including but not limited to the securities identified in Appendix A.

291. As a proximate result of Defendants' actions, the People suffered damages in a specific amount to be determined at trial.

THIRD CAUSE OF ACTION
Business & Professions Code § 17500
(Against All Defendants)

292. The People incorporate herein by reference the allegations in paragraphs 1 through 291 of this complaint.

293. S&P violated Business & Professions Code section 17500 by publicly making or disseminating untrue or misleading statements, or by causing untrue or misleading statements to be made or disseminated to the public, in or from California, with the intent to induce members of the public and investors to purchase S&P's ratings services and rely on its ratings of structured finance securities and/or to purchase structured finance securities rated by S&P. These untrue and misleading statements include but are not necessarily limited to:

(a) Statements that S&P's ratings of structured finance securities were independent, objective, and not influenced by its desire for revenue or pleasing issuers to gain their business or win additional business;

(b) Statements that S&P dealt fairly and honestly with the public, including the investors of the structured finance securities that it rated;

(c) Statements that S&P acknowledged and managed the conflict of interest inherent in the issuer-pays model;

(d) Statements that S&P adhered to stated criteria in assigning a credit rating and conducting ongoing surveillance to ensure that rated securities continue to reflect the assigned credit rating; and

(e) Statements regarding the ratings of thousands of specific securities.

294. Defendants knew, or by the exercise of reasonable care should have known, that their statements were untrue or misleading at the time they made them and at the time they rated structured finance securities during the relevant period alleged in this complaint.

FOURTH CAUSE OF ACTION
Unfair Competition - Business and Professions Code § 17200
(Against All Defendants)

295. The People incorporate herein by reference the allegations in paragraphs 1 through 294 of this complaint.

296. Defendants have engaged in, and continue to engage in, unlawful, fraudulent, or unfair acts or practices in the conduct of a business, which acts or practices constitute unfair competition, as that term is defined in Business and Professions Code section 17200. Such acts or practices include, but are not limited to, the following:

(a) Issuing ratings that were not independent, were not objective or credible, and were influenced by their desire for revenue or pleasing issuers to gain their business or win additional business;

(b) Failing to deal fairly and honestly with investors, including the investors of the structured finance securities that they rate;

(c) Failing to manage the conflict of interest inherent in the issuer-pays model;

(d) Violating Business and Professions Code section 17500, as described in the Fourth Cause of Action, above; and

(e) Violating Government Code section 12651, as described in the First and Second Causes of Action, above.

PRAYER FOR RELIEF

1. Wherefore, Plaintiff, the People, pray for relief against all Defendants as follows:

2. Pursuant to Government Code Section 12651 subdivision (a), three times the damages which PERS and STRS sustained as a result of Defendants' false claims in an amount to be determined.

3. Pursuant to Government Code Section 12651, subdivision (a), the maximum allowed Civil penalties for each false claim.

4. Pursuant to Business and Professions Code section 17536, that Defendants, and each of them, be ordered to pay a civil penalty in the amount of $2,500 for each violation of Business and Professions Code section 17500 by Defendants, in an amount according to proof.

5. Pursuant to Business and Professions Code section 17206, that Defendants, and each of them, be ordered to pay a civil penalty in the amount of $2,500 for each violation of Business and Professions Code section 17200 by Defendants, in an amount according to proof.

6. Pursuant to Business and Professions Code sections 17203 and 17535, that Defendants, and each of them, be enjoined from engaging in violations of the California Unfair Competition Law and the California False Advertising Law, including without limitation the unfair, unlawful, and deceptive practices alleged herein.

7. That the Court make such orders or judgments as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of unfair competition, under the authority of Business and Professions Code section 17203.

8. That the Court make such orders or judgments as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of any practice declared to be unlawful by Business and Professions Code section 17500 et seq., under the authority of Business and Professions Code section 17535.

9. That the People recover their costs of suit, including costs of investigation.

10. Such further or additional relief as the Court deems proper.

Dated: February 5, 2013

Respectfully Submitted,

KAMALA D. HARRIS
Attorney General of California
MARTIN GOYETTE
Senior Assistant Attorney General

Frederick W. Acker

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APPENDIX A

CalPERS Losses on Sale on RMBS Rated by S&P

SECURITY DESCRIPTION	CUSIP	TRADE DATE	S&P RATING AT TIME OF PURCHASE	LOSS ON SALE
CWALT 2007-20 A12	02151LAM8	8/23/2007	AAA	-$57,640,787.23
PRIME 2007-3 1A1	74162WAA6	8/14/2007	AAA	-$40,116,227.74
SVHE 2007-1 2A1	83612PAB6	2/23/2007	AAA	-$36,308,491.25
WASI 2007-HE1 A	92976YAA0	3/16/2007	AAA	-$31,595,791.80
AHM 2005-1 7A1	02660TDJ9	3/29/2005	AAA	-$25,950,497.65
BSARM 2005-7 1A1	07387ACX1	8/5/2005	AAA	-$20,571,725.79
CWALT 2007-23CB A1	02151EAA0	8/8/2007	AAA	-$20,112,603.02
MSAC 2007-NC4 A2A	61755EAB4	6/15/2007	AAA	-$19,581,057.96
CWHL 2006-1 A2	126694XC7	1/27/2006	AAA	-$16,850,107.41
RALI 2005-QA4 A31	76110H4J5	3/30/2005	AAA	-$15,884,634.29
WMHE 2007-HE2 2A1	92926SAB2	4/4/2007	AAA	-$14,360,036.63
MSHLC 2007-1 A	55352RAA6	2/22/2007	AAA	-$12,432,241.37
GSR 2006-1F 5A1	3623417Z6	1/25/2006	AAA	-$11,225,669.66
RAMC 2007-3 AF1	75971FAD5	8/31/2007	AAA	-$10,544,905.33
CMLTI 2007-AMC2 A3A	17311XAA3	2/15/2007	AAA	-$9,627,653.72
CWL 2007-S1 A1A	12669RAA5	2/23/2007	AAA	-$8,943,152.05
WMALT 2007-HY1 A1	93936AAA9	1/19/2007	AAA	-$8,898,642.25
RALI 2005-QA4 A41	76110H4L0	3/30/2005	AAA	-$8,671,543.11
CBASS 2007-CB1 AF1A	1248MGAJ3	1/26/2007	AAA	-$8,416,043.45
CWL 2006-S8 A1	12668XAA3	12/7/2006	AAA	-$6,589,122.49
CWHEL 2007-B A	12669XAE4	3/19/2007	AAA	-$6,469,026.12

LBAHC 2006-11 N1	92933KAA2	12/19/2006	A-	-$6,436,345.43
ELAT 2007-2 A2A	288547AB8	10/4/2007	AAA	-$9,553,364.46
FFMER 2007-4 2A1	59025CAB6	6/18/2007	AAA	-$6,089,210.34
FFMER 2007-3 A2A	59024VAE9	5/23/2007	AAA	-$5,880,102.82
CWL 2007-S1 A1A	12669RAA5	2/23/2007	AAA	-$5,809,308.97
WFMBS 2005-8 A1	94982VAA4	9/8/2005	AAA	-$5,786,831.58
RAMC 2007-3 AF1	75971FAD5	8/31/2007	AAA	-$5,767,853.61
CWL 2007-S2 A1	12670BAA7	3/23/2007	AAA	-$5,740,876.78
SAST 2007-3 2A1	80557BAB0	7/27/2007	AAA	-$5,666,277.28
CWHL 2005-HYB2 2A	12669GWU1	3/30/2005	AAA	-$5,428,403.57
MSM 2007-6XS 2A1S	61751JAF8	3/16/2007	AAA	-$5,311,539.96
WMHE 2007-HE1 2A1	933631AB9	1/11/2007	AAA	-$5,248,896.06
WFMBS 2005-8 A1	94982VAA4	9/8/2005	AAA	-$5,036,056.31
FHABS 2007-HE1 A	32053JAA5	6/19/2007	AAA	-$4,987,911.67
WFMBS 2004-2 A1	949800AA4	2/9/2004	AAA	-$4,258,541.73
ACE 2007-HE1 A2A	00443LAB4	1/26/2007	AAA	-$3,721,655.01
FMIC 2006-3 2A1	316599AB5	10/20/2006	AAA	-$3,218,486.09
FFMER 2007-2 A2A	59024QAB6	4/16/2007	AAA	-$3,190,980.74
CWL 2007-12 2A1	126697AC5	8/17/2007	AAA	-$3,169,444.90
BOAMS 2005-L 4A1	05949CPP5	12/22/2005	AAA	-$3,151,086.93
FHABS 2006-HE2 A	32052XAA5	11/15/2006	AAA	-$3,117,465.48
BAFC 2006-1 2A1	05949TBD0	1/19/2006	AAA	-$3,062,564.67
FHASI 2005-AR6 4A1	32051GJ89	12/7/2005	AAA	-$2,964,692.70
SARM 2004-16 5A3	863579EU8	10/26/2004	BBB+	-$2,936,197.06
MSM 2006-15XS A1	61750YAA7	10/18/2006	AAA	-$2,851,730.17

FFMER 2007-5 2A1	59025RAT4	9/25/2007	AAA	-$2,408,406.46
JPMAC 2007-CH4 A2	46630CAB0	6/7/2007	AAA	-$2,256,568.20
BOAMS 2005-L 4A1	05949CPP5	12/22/2005	AAA	-$1,975,734.14
NSTR 2007-C 2AV1	63860KAB8	5/23/2007	AAA	-$1,815,401.78
MABS 2007-HE2 A2	57646LAA1	8/24/2007	AAA	-$1,757,542.30
MSM 2006-15XS A1	61750YAA7	10/18/2006	AAA	-$1,604,098.22
CMSI 2004-1 3A1	172973VQ9	1/28/2004	AAA	-$1,536,081.43
BAFC 2005-G A1	05946XB85	9/16/2005	AAA	-$1,409,405.80
CWL 2007-3 2A1	12668UAE1	3/16/2007	AAA	-$1,396,871.43
CMLTI 2004-HYB2 3A	17307GED6	4/15/2004	AAA	-$1,154,449.63
ACE 2007-HE1 A2A	00443LAB4	1/26/2007	AAA	-$1,132,677.61
JPMAC 2007-CH3 A2	46630XAC2	5/3/2007	AAA	-$1,032,399.57
SVHE 2007-NS1 A1	83612QAA6	3/2/2007	AAA	-$931,070.91
FFML 2007-FF1 A2A	32028TAB3	1/22/2007	AAA	-$897,746.30
BOAMS 2004-3 4A1	05949ACB4	3/3/2004	AAA	-$886,696.93
SAST 2007-2 A2A	80556YAB1	4/18/2007	AAA	-$885,529.74
FFML 2007-FF2 A2A	32029GAB0	2/23/2007	AAA	-$726,625.08
CWL 2007-1 2A1	23245CAB6	1/26/2007	AAA	-$705,113.65
RAMP 2004-SL1 A7	760985W80	3/17/2004	AA-	-$467,185.38
BAFC 2006-2 3A1	05949QBE4	1/31/2006	AAA	-$387,478.92
RAMP 2004-SL1 A8	760985W98	3/17/2004	AA-	-$369,895.08
BOAMS 2004-5 4A1	05948X7Q8	7/8/2004	AAA	-$356,465.93
BSARM 2004-2 14A	07384MM66	4/21/2004	AAA	-$354,726.78
OOMLT 2007-2 3A1	68401TAC2	3/2/2007	AAA	-$334,954.74
OOMLT 2007-3 2A1	68402BAB2	3/30/2007	AAA	-$331,950.68

BAFC 2004-C 1A1	05946XLS0	11/10/2004	AAA	-$328,827.01
BOAMS 2004-3 3A2	05949ABZ2	3/23/2004	BBB	-$328,033.12
OOMLT 2007-5 2A1	68403HAB8	4/19/2007	AAA	-$286,022.66
JPMAC 2006-CH2 AV2	46629QAT3	11/21/2006	AAA	-$279,139.81
BOAMS 2005-H 4A2	05949CGE0	8/10/2005	AAA	-$240,469.11
RASC 2007-KS3 AI1	74924YAA1	3/26/2007	AAA	-$170,473.19
JPMAC 2006-CH2 AF1A	46629QAA4	11/21/2006	AAA	-$112,565.33
CWL 2006-S5 A1	126683AA9	9/15/2006	AAA	-$72,430.59

Total = -$538,108,822.13

CalPERS Realized Losses on SIV Securities Rated by S&P

SECURITY DESCRIPTION	CUSIP	PURCHASE DATE	S&P RATING AT TIME OF PURCHASE	REALIZED LOSSES
CHEYNE	16705EAV5	2/10/2006	AAA/A-1+	-$199,700,000.00
	16705EAX1	2/16/2006	AAA/A-1+	
	16705EBN2	4/20/2006	AAA/A-1+	
	16705ECK7	9/21/2006	AAA/A-1+	
	16705EDA8	11/1/2006	AAA/A-1+	
STANFIELD VICTORIA	85431AFE2	2/16/2006	AAA/A-1+	-$354,200,000.00
	85431AFA0	2/16/2006	AAA/A-1+	
	85431AFC6	2/16/2006	AAA/A-1+	
	85431AFD4	2/16/2006	AAA/A-1+	
	85431AFF9	3/9/2006	AAA/A-1+	
	85431ADP9	8/4/2006	AAA/A-1+	
	85431ADT1	8/4/2006	AAA/A-1+	
	85431AHA8	9/8/2006	AAA/A-1+	
	85431AHV2	10/26/2006	AAA/A-1+	
SIGMA	8265Q0TF9	9/26/2006	AAA/A-1+	-$225,000,000.00
	8265Q0TM4	10/13/2006	AAA/A-1+	
	8265Q0WL2	3/29/2007	AAA/A-1+	
			Grand Total =	**-$778,900,000.00**

CalSTRS Losses on Sale on RMBS Rated by S&P

SECURITY DESCRIPTION	CUSIP	TRADE DATE	S&P RATING AT TIME OF PURCHASE	LOSS ON SALE
BSALTA 2006-8_II-A-2	07387QAN0	5/22/2007	AAA	-$14,820,511.24
CWL 2006-11_1AF-4	12666TAD8	9/6/2006	AAA	-$5,635,950.79
CWL 2006-S3_A3	23242MAC5	8/25/2006	AAA	-$3,667,248.71
GMACM2007-HE2_A4	36186LAD5	6/27/2007	AAA	-$2,767,575.26
NAA 2005-AP3_A3	65535VPD4	2/5/2007	AAA	-$2,618,512.27
CBASS 2007-CB2_A2E	1248MBAL9	2/27/2007	AAA	-$2,562,974.54
CMLTI 2007-AR5_1A1A	17311LAA9	5/22/2007	AAA	-$1,939,962.84
NAA 2007-1_IA3	65538PAD0	5/8/2007	AAA	-$1,882,504.33
CWL 2005-11_AF-4	126670CJ5	8/1/2006	AAA	-$1,873,934.92
CWL 2007-S2_A4F	12670BAD1	3/26/2007	AAA	-$1,677,218.74
			Total =	**-$39,446,393.64**